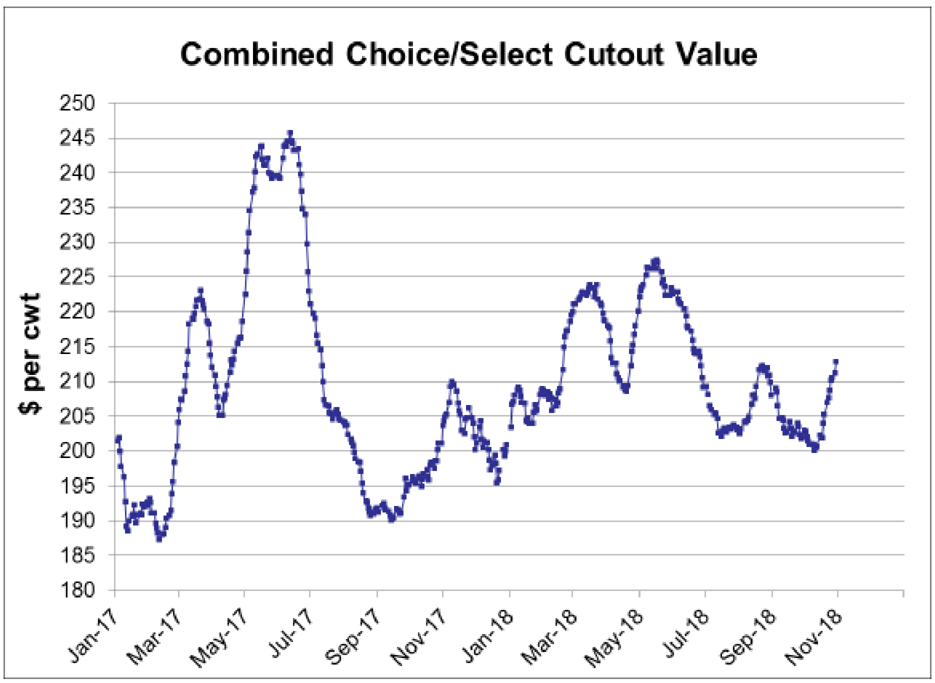
MEAT MARKETS
UNDER A MICROSCOPE

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

October 31, 2018

I should begin with an erratum to last week's *Meat Markets under a Microscope*, which I opened by stating that the combined Choice/Select cutout value was headed for $112 per cwt. I meant $212 per cwt. I'm sure that you figured that out right away. Anyway, the market has already moved to that level….and, as of this morning, beyond.



I didn't think it would happen this time around, but the combined cutout has risen above its August peak. Such a signal cannot be ignored. However, I'm skeptical that this means it is headed directly for $227, which is now the nearest resistance level on the chart. This situation requires some serious, logical reasoning, something I usually try to avoid.

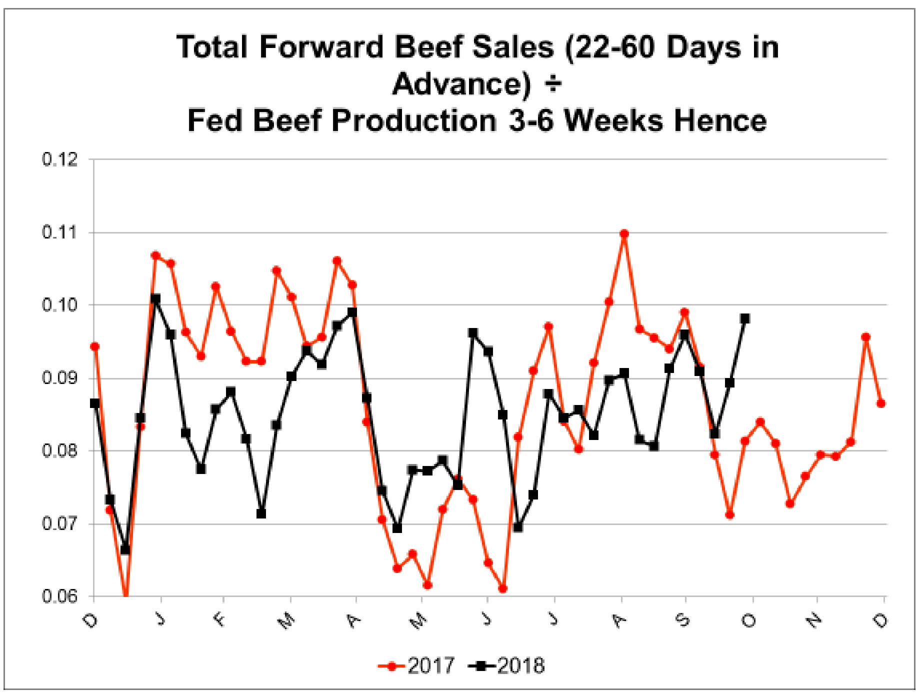
Although some of the round cuts that sponsored this rally in the cutout—namely, bottom round flats and knuckles—are bumping against major resistance levels, there are other parts of the carcass that seem to have further upside potential in the near term.

Ribeyes would be one of these, of course. Ribeyes of the Choice persuasion have gained significant ground between now and Thanksgiving in 15 of the last 20 years, most often by 5-10%--which, in the case of boneless product, would amount to somewhere between 40¢ and 85¢ per pound. True, the expanding acceptance of "suspended fresh" programs (which function similarly to traditional freezer programs, except that fancier technology preserves product quality and permits it to be marketed as "fresh"….what a coup!) may curb demand for fresh ribeyes in the spot market, it's hard to bet against such a consistent seasonal track record. Plus, I notice that last fall's peak in Choice boneless ribeyes was just above $9.00 per pound. Why would that peak *not* be surpassed this time around? Choice ribeye prices have been above a year earlier for the past 13 weeks, most recently by more than $1.00 per pound. The same conditions generally apply to Select-grade rib meat, although I notice that there has been no material rally in this segment between now and Thanksgiving since 2014.

Another item that would fall into this category is the top butt, which has established its seasonal bottom about two weeks ahead of schedule. Again in this case, I wonder: last year this [Choice] market rallied from $2.75 per pound to over $3.00 between now and Thanksgiving, and to $3.25 by Christmas. What would prevent that from happening again? Clearly, demand has picked up in the past week.

A third item would be ground beef. It has come up a rather long way from its lows, but with 81% lean product trading at $1.70 per pound and ground chuck quoted yesterday at $1.84, are prices really expensive? They traded at almost exactly the same prices on this day a year ago. Forward prices during most of October were pretty attractive, leaving plenty of room for retail features through the end of the year.

Tenderloins could certainly be counted among this group as well. Currently, Choice tenderloins trade nearly $1.00 per pound below last fall's peak; Select tenderloins are now matching the fall 2017 peak, but their track record shows ten substantial gains and only three material losses in the last 20 years between now and Thanksgiving.



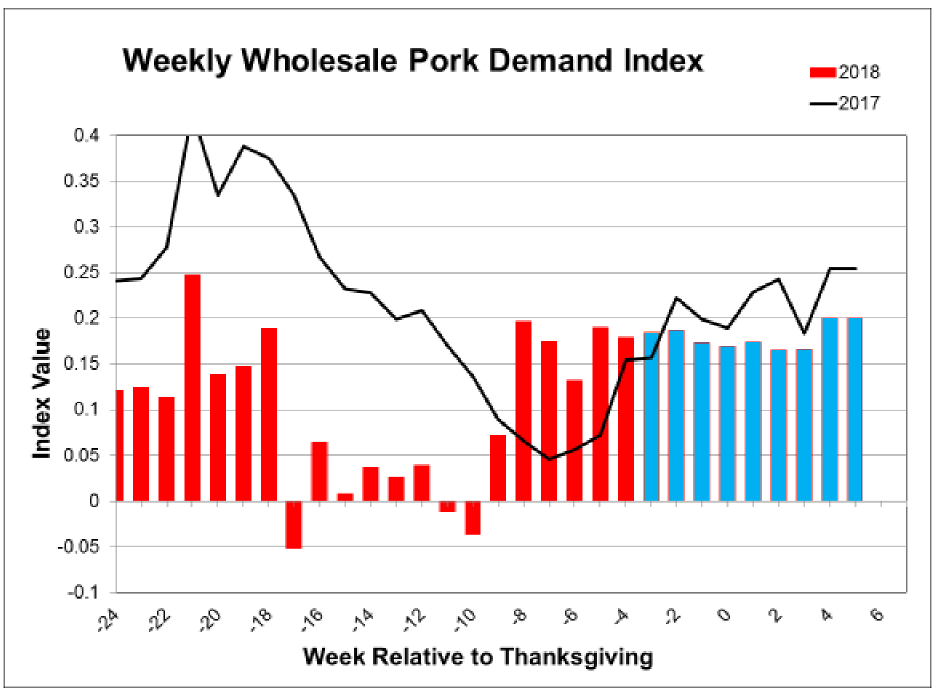
Meanwhile, forward booking activity has been brisk, indicating that supermarket featuring will be pervasive and that restaurants are gearing up for a busy holiday season. Perhaps the most impressive statistic is shown in the picture at left, which suggests that packers will be in a good "forward-sold" position in the weeks ahead, much healthier than they were a year earlier.

The beef market has been in pretty good balance ever since July. The range in monthly average cutout values has been only $3.32 per cwt over the past four months and, as evidenced by relatively flat demand index values, changes in demand have not strayed far from the normal seasonal path. That is about to change, however.

It looks very much as though demand for beef at the wholesale left will outperform the seasonal norm as we head into November, meaning that the monthly demand index is set to take a step upward. This will emphatically be the case if steer and heifer kills remain in the 500,000-505,000 range in the non-holiday weeks of November, and if cutout values are able to hold at or above current levels as the chart suggests. My assumption is that once this next upward step is taken, demand should be able to maintain along a typical seasonal path from that point forward. And why not?

So back to the original question: how far will the current rally in the combined cutout value extend before it flattens out again? My guess is that a new resistance level will be formed somewhere below $227, which is hardly a precise answer. But I notice that on average over the last 15 years, the highest cutout value during November-December has occurred during the week of Thanksgiving; and the average price change between now and then has been +0.54%, which would place the combined cutout in Thanksgiving week only about a dollar and a half above yesterday's quote. Based on the points we just discussed—and based on the appearance of the chart—I'm expecting a bit more than that.

Pork prices are giving up ground more slowly than most (whom I know) had anticipated. In fact, the cutout value stands only $.19 per cwt below the quote of a week earlier, while it remains $13.49 above the August 24 low. It's tempting to ascribe the relatively firm undertone to export business associated with China's looming reduction in pork output, but there is no evidence that this is happening just yet.



All that has really happened is that wholesale pork demand has recovered from a very depressed status in August and the first half of September, and it has been relatively stable over the past five weeks. In the chart at left, the first blue bar represents the third week prior to Thanksgiving, which is the week we are in the middle of right now. Nothing special.

It looks as though hog slaughter will move above 2.6 million this week. If the spring pig crop was not grossly overestimated, then it will average around 2,635,000 in the non-holiday weeks between now and Christmas. As I pointed out last week, many have already stamped USDA's spring pig crop as "WRONG", but that judgment would be premature. The slaughter rates that I just described would place the fourth quarter kill in alignment with the spring pig crop estimate, and it would place November and December kills in a typical relationship to the quarterly total.

If we are headed for sustained weekly volumes substantially above 2.6 million, it will be difficult for loins, butts, and boneless picnics trade any better than steady over the next month. Hams and lean trimmings, merely because they appear to be cheap, should be able to put on a nickel or so. But pork bellies are vulnerable to a pretty sharp break….are they not?

Belly prices are finishing the month of October nearly $.40 per pound higher than they did last year, and the strong prices that prevailed throughout the past month *should* curb the appetite for supermarket bacon features through the balance of the year. True, demand form the restaurant sector should remain stout and steady; but movement through supermarket channels is the “swing factor” which ebbs and flows with changes in wholesale costs and thus regulates the short-term balance in the market. Having held steady for two weeks now, the belly market appears to be topping out. There is no discernible support on the chart above $1.10 per pound, and that seems to be a reasonable target. If $1.10 sounds too cheap, consider that just two months ago this market traded below $.75; and in December 2017 it traded as low as $1.07. A move in pork belly prices from $1.40 to $1.10 would, by itself, shave roughly $4.50 per cwt off the cutout value. And so my humble guess is that the cutout value is headed for a fall low of about $73, down from yesterday’s quote of $77.67. This scenario, by the way, aligns with the sideways pattern in the weekly demand index shown on the previous page.

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.