MEAT MARKETS UNDER A MICROSCOPE

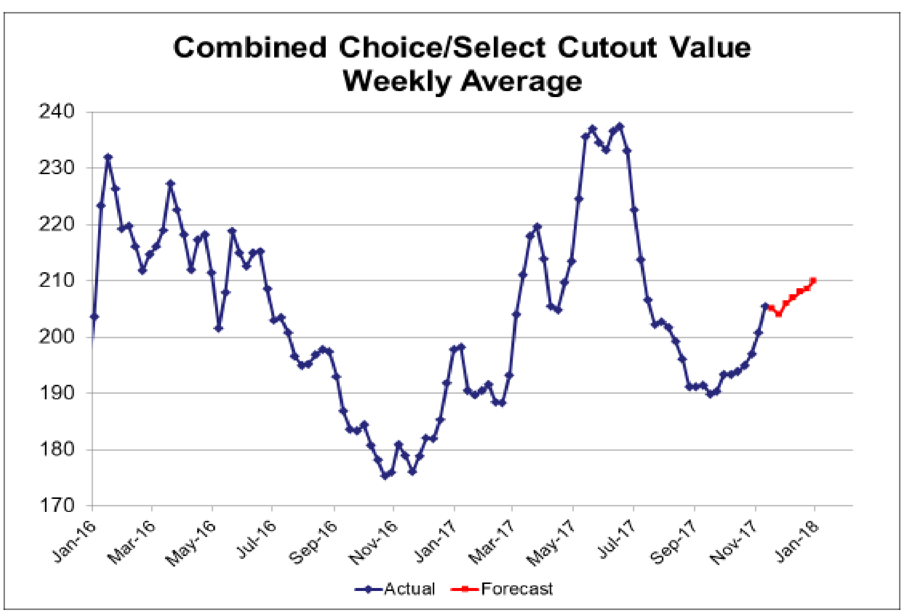
A perspective on the red meat markets by Kevin Bost...sometimes wrong, usually scientific, but always candid

November 14, 2017

Cutout values have paused, and in fact, taken a few steps backward since last Wednesday. Chances are, though, that they are simply marking time, and not heading into something that could be called a "break".

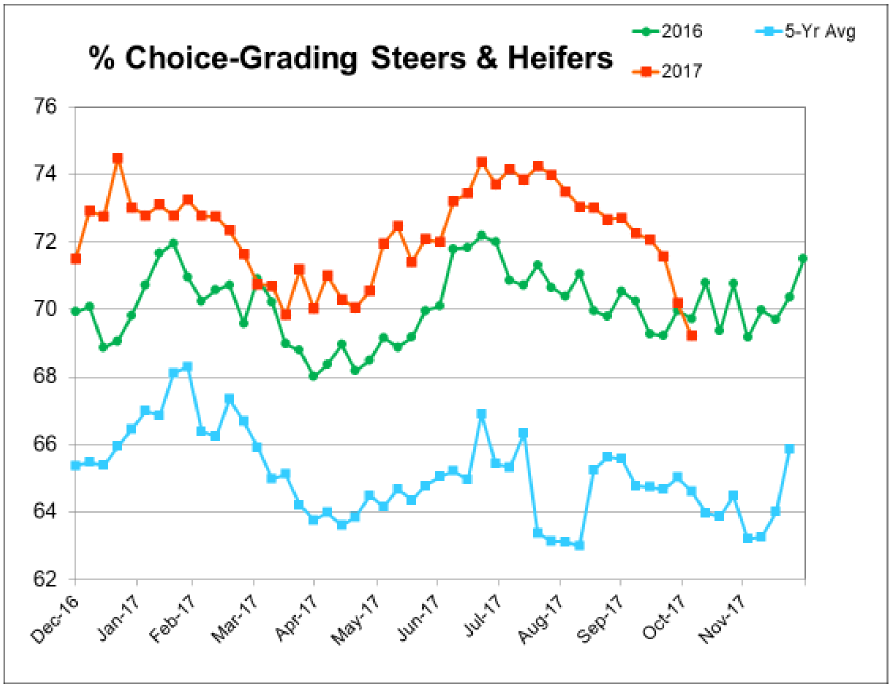
First of all, wholesale demand would have to be substandard in order to prevent the combined Choice/Select cutout from trading higher in the middle of December than it does today. I can't think of a compelling reason why that would happen (underperforming demand, that is). Cutout values have gone up eight weeks in a row now, but the ascent has been pretty gradual. As best I can tell, prices have not become so expensive as to choke off demand prior to Christmas (chuck rolls may be the lone exception). Choice ribeyes and tenderloins, of course, have tacked on a lot of money over the past two and a half weeks, but this will not come to bear on the spot market until holiday deliveries are completed. [More on this subject in a minute.] In the meantime, they possess further upside potential. Bookings for December delivery have tapered off, but they have been healthy enough, I think, to prevent a "logjam" before mid-December. Forward booking statistics are sometimes difficult to interpret with precision, and I admit that we tend to do so through whatever glasses we choose to wear.

So, then, if the change in demand between now and the second week of December matches its average performance of the last 20 years, the combined Choice/Select cutout value will be about $3 per cwt higher at that time than it is now.



Actually, that would be very near the 20-year average change in the cutout value over this time frame. I expect that beef production in the second week following Thanksgiving will be about the same as it was two weeks prior to Thanksgiving (i.e., this past week). So we're not talking about anything unusual here.

Before I go any further, I want to mention that the theory that a recalibration of grading instruments would lead to a sharp reduction in the grade-out is confirmed—not by anything that anyone said, but by the market. The most recent official grading statistics were for the week ended November 4th, the last red data point on the chart below.



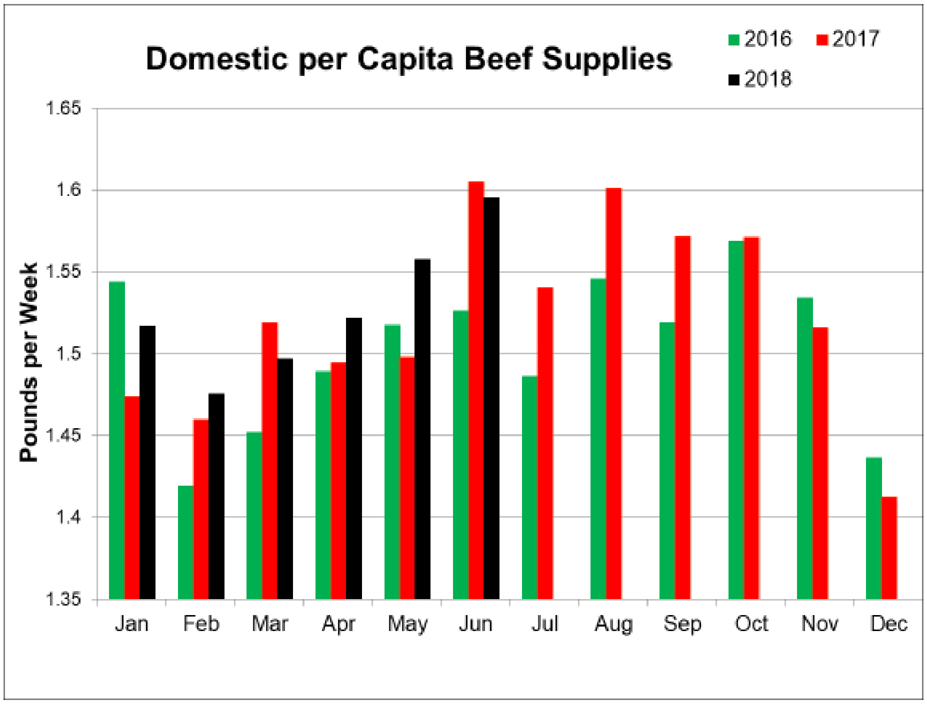
It is becoming evident that packers are indeed winding up with less Choice-grade product to sell, and more Select-grade product than they had anticipated. This, I think, enhances the near-term upside potential in Choice ribeyes and tenderloins, and stunts the upside potential of their Select-grade cousins. I am therefore approaching the buy side of the latter with caution.

Otherwise, my attention is focused on the longer-term cycle in wholesale beef demand, which I'm guessing will reach a practical peak here in November. I expect to see higher prices develop for first quarter deliveries, which should curtail retail beef featuring in January and February, which in turn would be manifested by a downturn in the seasonally adjusted demand index.

A bit of historical study would be fun and perhaps useful at this point. The monthly demand index reached a cyclical low in August/September (it was practically the same in those two months), and has risen sharply since then. This led me to wonder: has this ever happened before, that the index rose sharply from August or September to November/December? And if so, what did it do in January/February?

Well, the answer at which I arrived was kind of a dead end. So it goes with research. Since 1990, there have been six years in which the demand index showed an increase from September to February similar to this year's increase; on half of those occasions, the index declined from November to February, and on the other half, it increased. Oh well. Simple history neither supports nor denies my postulation. Anyway, if the index were not to change at all between now and the first two months of 2018—meaning that the seasonal change in demand would equal the 20-year average—then the combined cutout value in January would average about $6 per cwt higher in January, and about $2 higher in February than it is quoted today.

These forecasts assume that net domestic beef supplies will look something like that which is shown in the picture on the next page….and this picture, in turn, includes the export projections shown in the table immediately following.



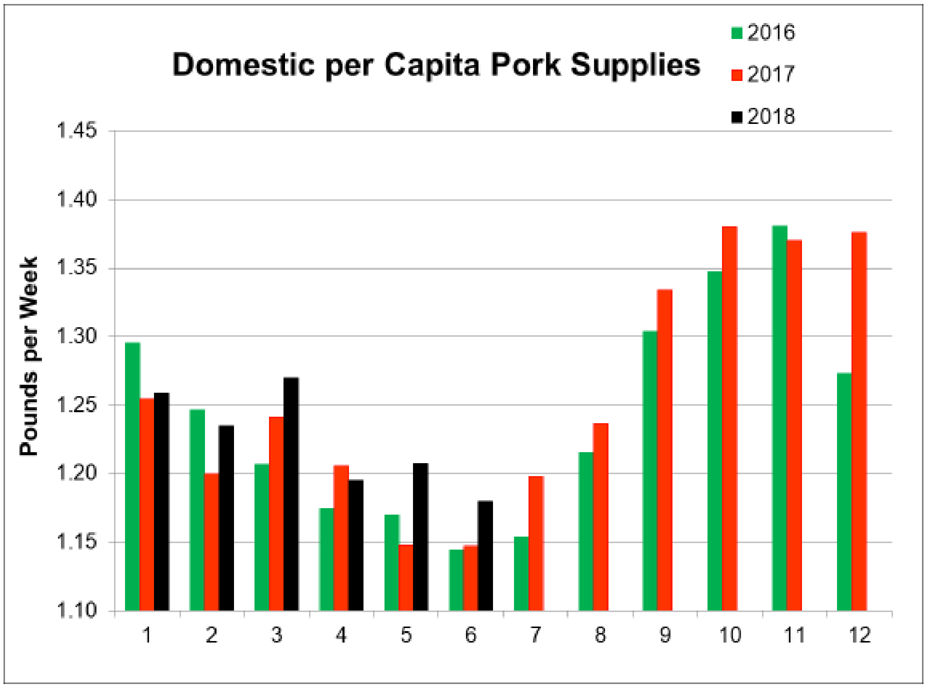
Quarterly U.S. Beef Exports, Million Pounds

	Q4 2017 Volume	Q4 2017 % Change	Q1 2018 Volume	Q1 2018 % Change	Q2 2018 Volume	Q2 2018 % Change
Japan	192	+19	203	+2	235	+16
Korea	152	+4	120	+14	126	+18
HK/China/Taiwan	159	+4	119	+18	124	+7
Mexico	110	+3	100	+5	105	+5
Canada	89	+6	78	-1	89	+18
Total	784	+7	693	+6	759	+11

….and while we're at it, the equivalent pictures in the pork market:

Quarterly U.S. Pork Exports, Million Pounds

	Q4 2017 Volume	Q4 2017 % Change	Q1 2018 Volume	Q1 2018 % Change	Q2 2018 Volume	Q2 2018 % Change
Japan	288	-6	310	-3	308	0
Korea	139	+12	159	+2	135	+2
HK/China/Taiwan	104	-20	114	-16	150	-16
Mexico	489	-2	465	0	445	+5
Canada	140	-1	127	+2	131	+2
Australia	40	-8	55	-9	51	+10
Total	1399	-4	1431	0	1426	0



Naturally, the near-term prospects for the pork cutout value center on the question of whether the spring pig crop was overestimated, or whether the industry is "underkilling" the hog supply. I find Smart People on both sides of the debate. I, being one who clings to USDA's pig crop estimates until I am forced to capitulate (for who am I to know better?), lean toward the notion that packers are purposely running fewer hours than they could be, in order to recover margins—which plunged just before hog slaughter started to come in below expectations….and since then have widened out considerably. And so, I am of the humble opinion that pork prices have been propped up by restrained production, and will come under pressure when production makes another leg up. It's looking more and more as though that will not happen this week. The word in the Sewing Circle is that this week's kill will be no bigger than last week's 2,495,000, and probably lower. Quite possibly, then, weekly totals will jump by nearly 100,000 head between now and the week after Thanksgiving.

This could make for some interesting price behavior among the individual cuts. To wit: ham prices could actually lose ground between now and the first full week of December (this *has* happened before, you know—five times in the last 20 years, to be exact); and loins, which typically increase in value between now and then, could remain dormant even after bone-in product has fallen to near 80¢ per pound over the past week. Belly prices have gone up in 15 of the last 20 years over the same time frame, but in this case, I would expect them to retreat. This is not such a bold prediction, though, considering that they have rallied 35¢ per pound since early October and were responsible for more than one half of the concomitant increase in the cutout value.

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.