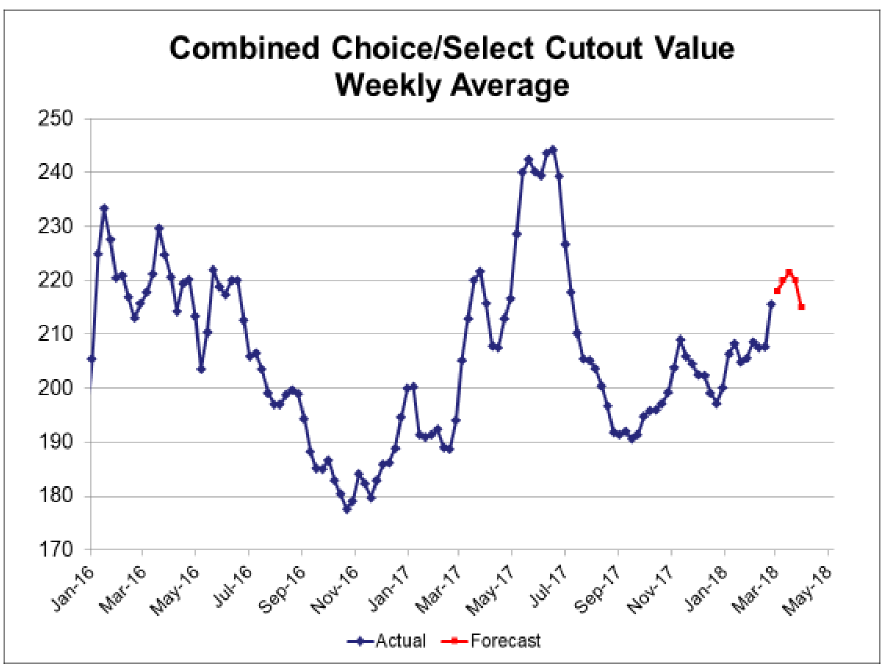
MEAT MARKETS
UNDER A MICROSCOPE

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

February 26, 2018

There was probably an element of the "Short-Bought Buyer Syndrome" involved in the sharp rally this past week in beef cutout values. Also involved was an understandable effort among packers to raise asking prices in response to the jump in live cattle prices (to $130 per cwt) on the previous Friday. Otherwise, I don't know how to explain the quick burnout of upward momentum. When I talk about short-bought buyers, I am mainly referring to—and I'm only guessing here—those, myself included, who were expecting a drop in chuck and round cuts that didn't materialize and were forced into the market.

Let's add to the list of temporary conditions a plunge in fed cattle slaughter this past week, down to 443,000; I expect an immediate rebound to 460,000-plus in the week ahead, and to 477,000 in March. In case you're raising an eyebrow at that prospect, a March average of 477,000 should be fairly easy to achieve in light of the March 1 inventory of cattle on feed 90 days or longer (up 15% from a year ago), and the fact that it would merely match the pace of a year earlier.



But the chart of the combined Choice/Select cutout value certainly looks like it has more room to the upside before a major top is established. The $210 per cwt mark, having turned the market back on three separate occasions, had become an important resistance level. And so, it was no small deal that prices were able to drive through that level so emphatically.

The next resistance level of any consequence lies in the neighborhood of $221.50 on the weekly chart. For whatever reason, it was an important price in May 2016 and again in March 2017. Given the historically consistent upward bias in cutout values between now and mid-March, I have to think that the market will get there. It might also turn out to be high-water mark for the next six months, if not longer.

In the table below, I put forth my humble guess of how the combined cutout value will arrive at $221.50 three to four weeks from now.

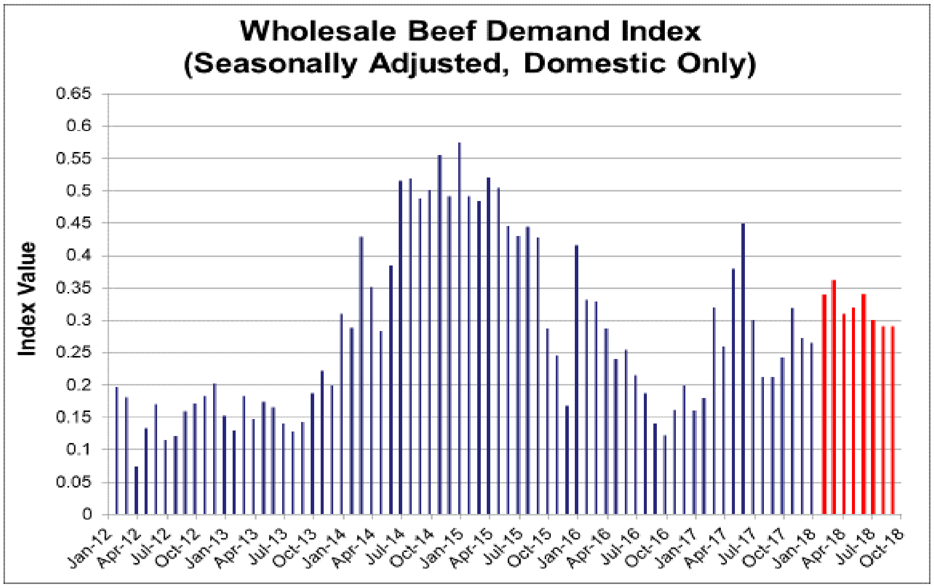
Expected Mid-March Trade Levels & Change from Last Week's Average:

CH Bnls Ribeyes	$8.20	$.83
SL Bnls Ribeyes	7.40	.61
CH 0x1 Strips	7.10	1.27
SL 0x1 Strips	5.80	.77
Ch Top Butts	3.95	.49
SL Top Butts	3.85	.41
CH Tenderloins	10.50	.81
SL Tenderloins	10.25	.51
Shoulder Clods	2.17	(.12)
Chuck Rolls	2.80	(.33)
Knuckles	2.39	(.08)
XT Inside Rounds	2.28	0
Bottom Round Flats	2.10	(.13)
Round Eyes	2.22	(.15)
Briskets	2.55	(.17)
CH Flap Meat	5.70	.38
CH Ball Tips	3.40	.30
CH Tri Tips	3.20	.07
81% Ground Beef	1.80	(.04)
50% Lean Trim	.95	.12

Assuming that the market will get there, this could be the practical peak through the third quarter. As my best guess is that the combined cutout will average just short of $220 per cwt in May, the May peak could be a bit higher—but not by much.

The main reason for thinking so is because it looks as though the seasonally adjusted wholesale demand index is headed for a cyclical peak in March. As I show in the picture on the next page, the index value here in February (represented by the first red bar) increased substantially from its January reading, which is to say that the change in wholesale demand from January to February was quite a bit stronger than seasonally normal. It now stands at its highest level since last June, and well above the previous 12-month average.

What makes me think that the index will not continue to climb? Well, I guess the answer is that for about the last two years there have been short-term cyclical peaks and valleys, but the basic trend has been sideways. It could be sensibly argued that domestic beef demand *should* be on its way upward because of the strong economy. But there is no evidence of that happening, at least not at the *wholesale* level. Besides, the index values in November and December were essentially equal to the previous 12-month average, and the state of the economy has not changed materially since then. The point is that the dominant trend in wholesale beef demand is sideways, and right now it stands near the top of that range…. therefore, the current strength is most likely due to short-term factors. The projections shown in the picture below assume that the demand index will remain above the previous 12-month average, just not by as much as it is today. From this angle, they might be regarded as a bit optimistic. These projections, along with a 2% year-over-year increase in net domestic beef supplies in March; a 4% increase in April; a 6% increase in May; and a 3% increase in June suggest that the combined cutout value will be bounded by $210 per cwt on the low side and $225 or so on the high side through the second quarter.



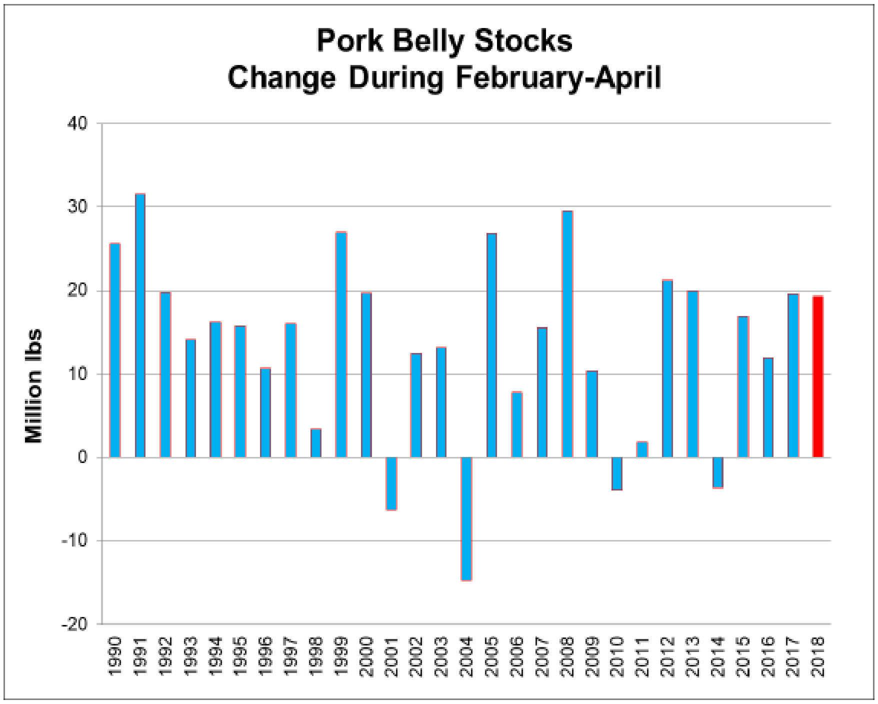
Moving on to the pork side of the menu, it looks as though production will be pretty flat from now through March. Following this past week's total of 2,373,000, hog slaughter should range from 2,375,000 to 2,390,000 over the next four weeks. It could be somewhat lighter in the final week of March due to the Easter holiday.

Therefore, demand will drive any material change in the pork cutout value between now and then…. especially demand for pork bellies and hams (what else is new?). In the case of the latter, we'll start with some simple history. Over the last 15 years, the "post-Easter low"—and by this, I mean the low point of the market after the end of the processing season for Easter delivery—has occurred nine times during the week prior to Easter Sunday; three times it occurred two weeks before Easter; once, three weeks before the holiday; and twice after the holiday. In 12 of the last 15 years—and in 16 of the last 20—ham prices lost ground between now and Holy Week. Finally, in eleven of the last 15 years, the post-Easter low either [practically] matched or descended below the late January-through-early March low. This is kind of clumsy-sounding, but what I'm getting at is this: how likely is it that 23-27 pound hams prices will go back down to 55¢ per pound? By itself, the history suggests that it's pretty likely.

But the rumors are swirling in the Sewing Circle about a sizeable export package of hams going to China in April and May. I do not know any details regarding the quantity or the timing, but I am inclined to believe that *something* is in the works, simply because I trust the source. The market will tell us the true story; if prices make another leg up from here, or if they do not begin to decline appreciably by the middle of March, then we'll know that we're probably dealing with a major quantity. That would change my attitude toward the April/May ham market. In the meantime, though, I'll plan on the "default" path…. i.e., a return to $.55 per pound, followed by a $.60 average quote in April. This forecast assumes that U.S. pork shipments to Mainland China will total 40-45 million pounds in both April and May, about the same as a year earlier.

It still seems to me that the belly market has more work to do in order to generate a sufficient amount of bacon business for the spring and summer. By "sufficient" I mean enough to absorb the additional supply that is on its way—which looks like it will be up 5% from a year earlier in the second quarter and up nearly 7% in July/August—without forcing someone in the processing business to "pull his pants down" somewhere down the road. In each of the past two years, that required a sub-$1.20 per pound market in the springtime. Why would it be any different this time around?

Included in my projection of belly supplies is the assumption that accumulation of frozen inventory will proceed at a semi-normal pace between now and the May 1 peak:



A 19 million-pound increase in belly stocks during February through April would leave them at 64 million pounds on May 1 vs. 34 million a year earlier. The additional 30 million pounds of frozen product is a major reason why belly supplies should be up as much as I am suggesting. And the larger buffer stock is probably enough to make the difference between a $1.85 per pound summer price peak and the $2.15 peak we saw last year….

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.