



MEAT MARKETS UNDER A MICROSCOPE

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

April 16, 2018

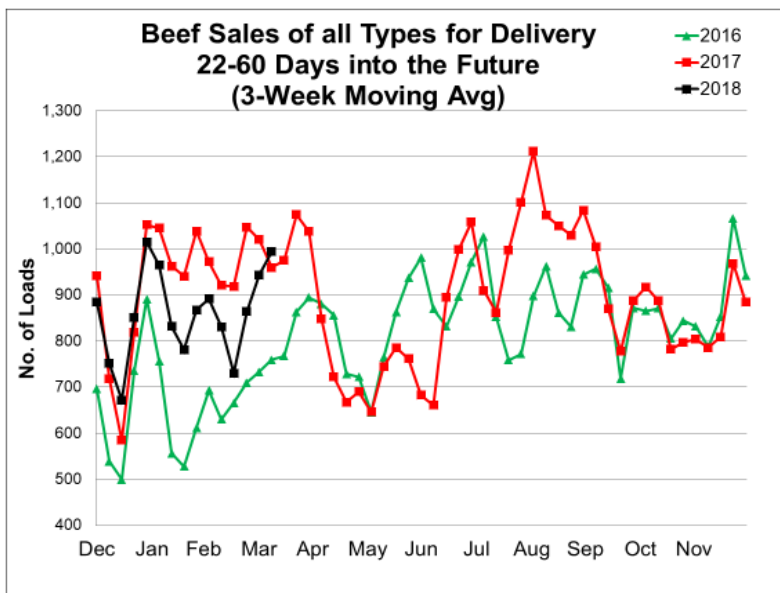
The combined Choice/Select cutout value seems to be finding support at \$210 per cwt, which is a likely place for a temporary bottom, according to the chart. Also, it has been on the decline for four weeks now, and I think I have mentioned before that the typical duration of this seasonal setback is three to five weeks. The next significant move is likely to be upward, as the increase in demand outweighs the increase in supply as we move into May.

The 15-year average change in the cutout value from mid-April to mid-May is +2.9%, including three years in which it depreciated. [I should point out that in those three exceptional years—2004, 2007, and 2011—there was a substantial rally from mid-March to mid-April.... a stark contrast to this year.] A 2.9% increase this time around would carry it up to about \$217 in the week ending May 19. My guess, though, is that the rise will be somewhat steeper than that. The increase in steer and heifer slaughter should actually be a bit smaller than average, even as it reaches 530,000 in mid-May. At that rate of production, a typical seasonal change in demand over the next four to five weeks would place the combined cutout near \$220 in the two weeks prior to Memorial Day.

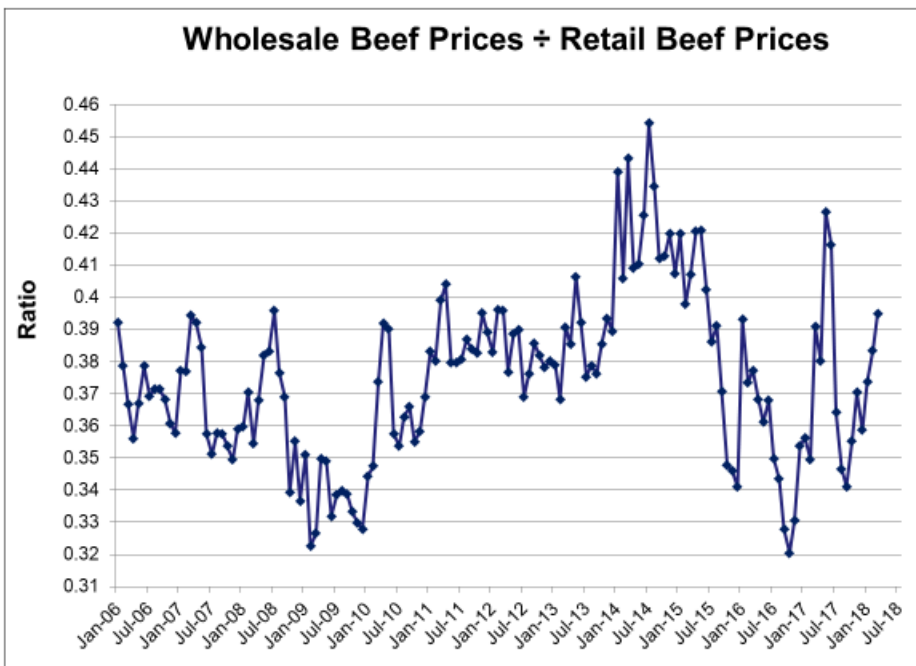
I do not know of a good reason why the pattern in wholesale beef demand in the near term should be materially stronger or weaker than average. True, I have been deriding the “slackness” in the forward-booking volumes of February and March, but they haven’t been

terrible—just not as strong as they were last year:

I have noticed that just within the past week or so, asking prices for deferred delivery have started to come down—but not in time to generate large-scale, aggressive retail beef ads in May (unless they are at the very *end* of May). If the trends in forward pricing and forward booking keep moving in this direction, then June will be a good month for beef featuring. But in the meantime, there should be no shortage of product to sell in the spot market.



In the broader picture, packers will *have* to keep forward prices down for June and July delivery in order to prevent product from “backing up in the pipeline”, so to speak. [To normal people, that phrase sounds like it has something to do with sewage, doesn't it? But in the World of Meat it is accepted as graceful expression.] It is during May, June, and July that the supply-side pressure on the market will be most intense, and so the rate of flow through the marketing channel must keep pace. This will require relatively low retail prices (especially considering the heightened competition from pork), which will in turn require relatively low wholesale prices—particularly in the market for deferred delivery—because it doesn't *look* like retailers have a lot of margin money to spend on aggressive meat ads. And I hear the same sort of thing from The People In The Know.... that supermarkets generally are not content with their meat margins right now. As I show in the picture below, wholesale beef prices (as represented by the cutout value) are kind of high in relation to retail beef prices (as reported by the Bureau of Labor Statistics). And I don't show it here, but average retail beef prices currently stand 2% above a year earlier.



OK, so how does the combined cutout value get to \$220 per cwt from here (\$210)? Well, if all the end meats, briskets, and trimmings were to hold steady at current price levels (a formidable challenge, I think); and if ground beef prices were to gain \$.15 per pound by mid-May; then \$10 could be added to the combined cutout value only by increasing the price of middle meats by

an average of \$.65 per pound. I think this is rather easily done. More precisely, we're probably talking about gains of \$1.50 per pound in Choice ribeyes and \$.50 in Select; \$2.00 per pound in Choice 0x1 strips and \$1.00 in Select; \$1.00 per pound in Choice and Select tenderloins; \$.50 per pound in Choice top butts, but no gain on the Select side; and \$.40-\$.50 per pound gains in all bottom sirloin cuts (by the way, what the hell happened to ball tips this past week?), combined with \$.15 per pound losses in end meats.

I cannot leave the subject of beef without sharing something that caught my attention. I can identify with it because in 1981, my next-door neighbor in the duplex shot his roommate over pitcher of Kool Aid; and because there are times in which I, too, would probably take a bullet for a Slim Jim:

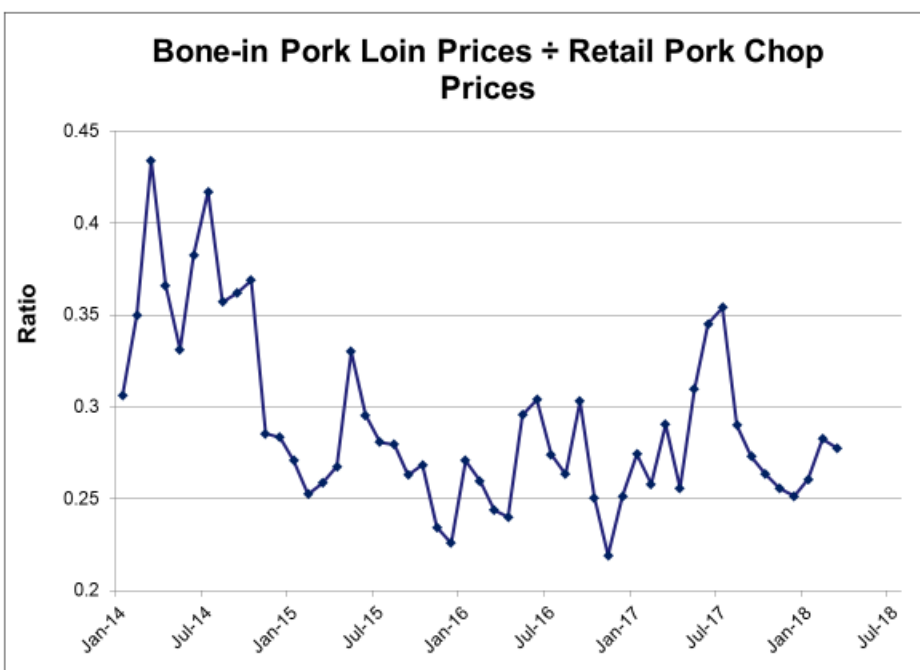
HOUSTON —A beef over a Slim Jim led a Texas gas store owner to shoot a customer in the leg, KTRK reported.

While Allen pumped gas, he said Carson went inside the store and returned with a Slim Jim. That's when Kahloon followed Carson and accused him of theft.

Allen said Carson had paid about \$1 for the snack, KPRC reported. Allen said Kahloon came out and said the Slim Jim cost \$2.15, including tax. Allen said there was an argument, Carson pushed the store owner and then was shot in leg.

"I think if I shot you right now, it wouldn't matter what it was about, I would be in handcuffs," Allen said. "It's amazing, over a Slim Jim. A \$1.99 Slim Jim."

Pork prices are well-positioned for "hot" retail features, and therefore a surge in wholesale demand between now and Memorial Day.... I'm talking about something beyond the seasonal norm. Since loins are the most outstanding value on the pork menu right now, I'll focus on these. Below is the Pork Chop Equivalent to the preceding picture, followed by one showing both wholesale prices and retail prices on the same graph:

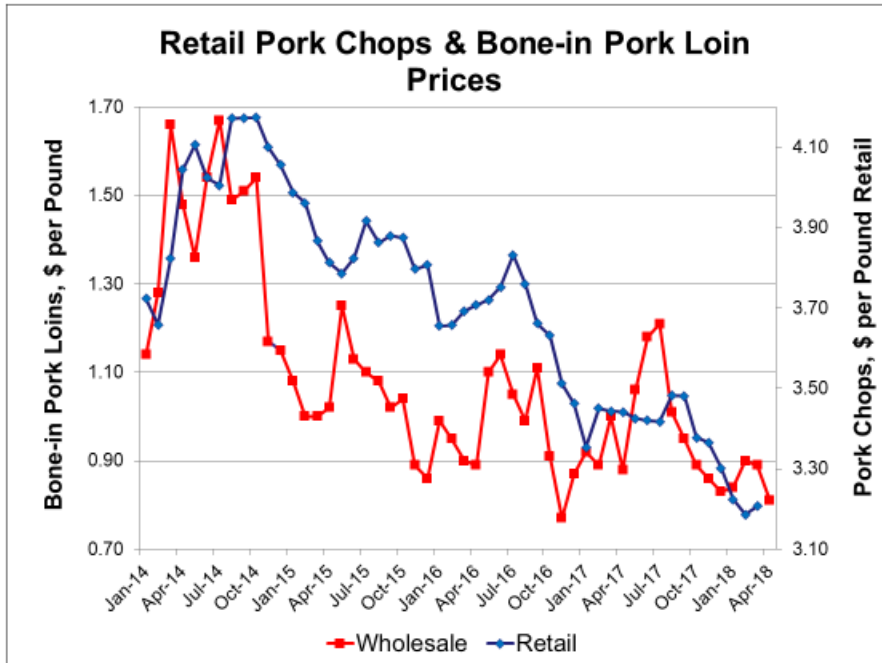


The retail price series I'm using is that which is reported by the U.S. Bureau of Labor Statistics under the heading, "All Pork Chops" (sounds like a reasonable choice, doesn't it?).

I'm not showing you this just to add to the Great Garbage Heap of Information, but to make a couple of relevant points. One is that while the ratio of wholesale to retail

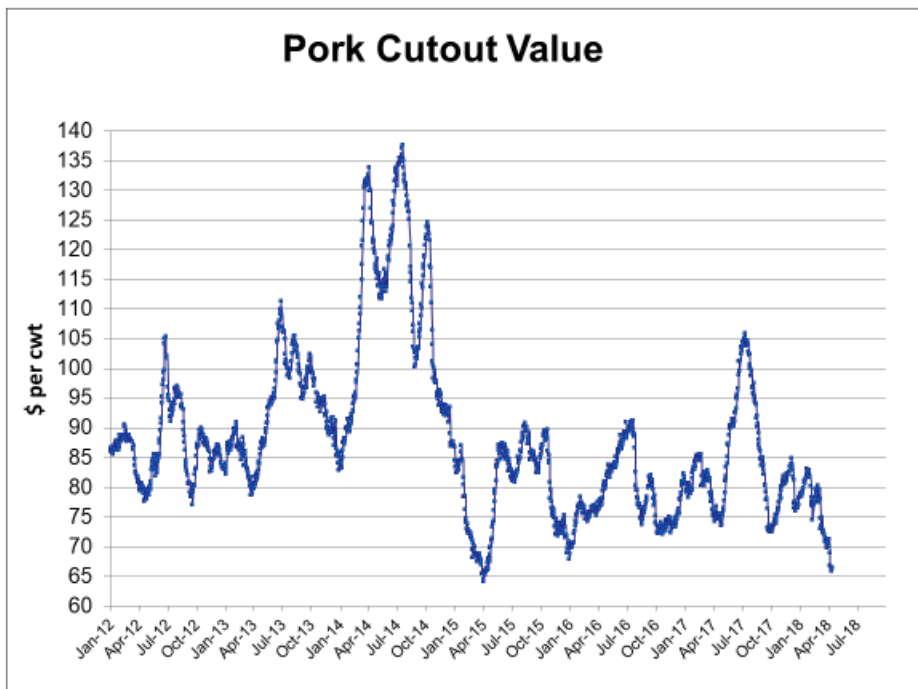
prices is not exceptionally low, it only measures about .28. Even with a finished product yield of only 80%, an \$.80 per pound bone-in loin would bring the yielded cost up to only \$1.00 per pound. Thus, a bone-in pork chop retailing at \$1.49 would offer a gross margin of nearly 50%. Another way to look at it is that bone-in loins could rally 20¢ per pound from here without putting a dent in the retail margin. I expect that this is the sort of rally that we will see between now and mid-May.

The second point is simply that retail prices of pork chops are clearly descending. As of March, they stood 7% below a year earlier. Descending retail prices accelerate the flow of product and are therefore bullish of demand at the wholesale level.



It's not just the pork loin that prompts me to be bullish of the pork cutout value in the near term. With the exception of spareribs, I don't find anything in the pork market that does not look like it is going up from here. Of course, even the shoeshine guy knows that pork prices go up at this time of year. All I'm saying is that the rate of ascent could surprise some people.

The chart of the cutout value shows formidable resistance in the neighborhood of \$85 per cwt, which should be evident from the long-term picture shown below. If weekly kills bottom out around 2,250,000 in June, and if the wholesale demand index bounces back from its extremely weak readings here in April to about where it stood in January and February, then the cutout value will top out this summer around \$90.



Finally, a word on last week's announcement that Argentina will reopen its border to U.S. pork. I am a bit surprised that the value being placed on this business is only \$10 million, given that USDA says pork consumption in Argentina is increasing rapidly, and since U.S. pork exports to Colombia and Chile amounted to 26 million pounds in February....

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