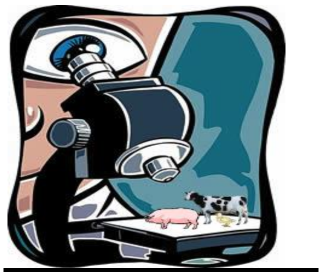


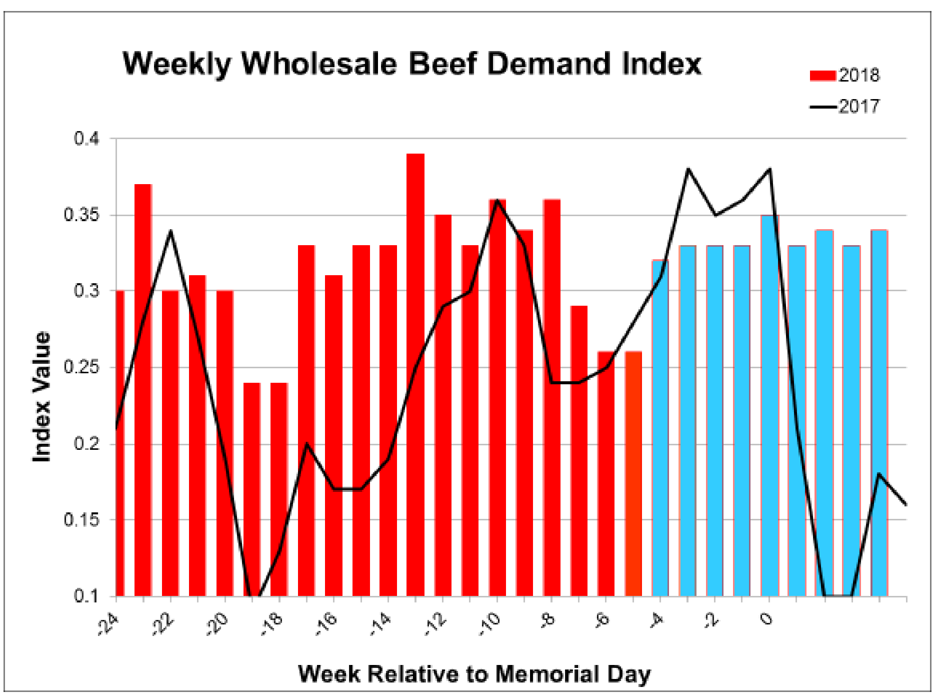
MEAT MARKETS
UNDER A MICROSCOPE

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

May 2, 2018

Last week's gains in the combined Choice/Select cutout value exceeded my expectations, and now it looks as though it is headed beyond the March high of $223.95 per cwt. After all, that's only $1.72 above today's quote.

I'm doubtful, though, that the ascent in the beef market will be able to maintain anything near its current pace between now and Memorial Day. As even the Shoe Shine Guy knows, there is a seasonal bias toward higher prices during May…. but it's not overwhelming. In the last 15 years there have been seven in which the combined cutout posted a significant increase between now and the week prior to the holiday…. once again, not overwhelming. I expect that this year will be one of them. Among those seven years, the average appreciation has been 4.5%. If we call this week's average $222.50, then a 4.5% gain would place the combined cutout value at $232.50 in the week ending May 26. It's a realistic target, I think, but certainly not one on which I would care to place a bet.

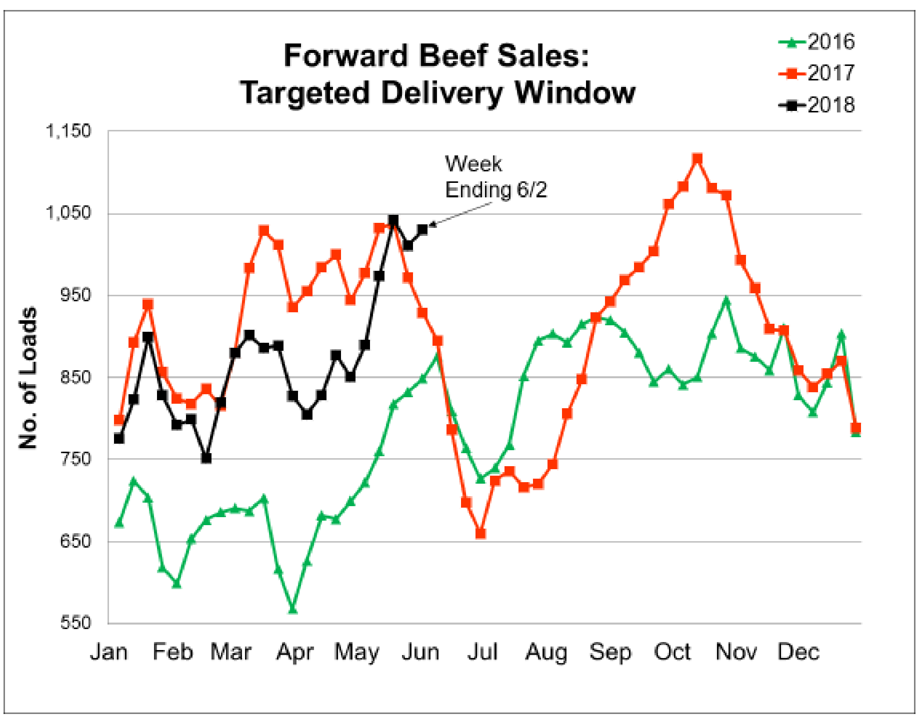


The $8.50 per cwt rally in the cutout last week was not the product of an unusual increase in demand. In the picture of the demand index at left, the final red bar is last week's reading, which merely held steady at a relatively low level. The rally, then, was inspired by a rather light kill—491,000 steers and heifers, which was actually down 4% from the same week last year.

It stands to reason, then, that the market has yet to demonstrate its ability to absorb the sharp seasonal increase in production that presumably lies ahead. I suspect that we will have a better clue by the end of this week, as the Smart People are saying that the total kill will be 640,000-645,000 head, with the fed cattle portion amounting to 511,000-516,000…. and on its way up to 535,000 within another two weeks. So let's wait and see.

Sure, the beef market has gotten out of the gate with some "pep" this week; but judging from the nearly across-the-board increase in asking prices Monday morning, it looks an awful lot like a reaction to higher cattle prices. Throw something up there, and see what sticks.

The fact remains that forward bookings for most May delivery dates were just not all that great. I sometimes read too much into these numbers, but they *do* coincide with the relatively weak readings of the wholesale demand index in the last couple of weeks. Now, having said that, let's refer back to the graph on the first page. The blue bars represent my humble forecasts through June, starting with the current week. If steer and heifer kills do indeed total 510,000-plus this week, and if the combined cutout does indeed average $222.50 per cwt, then the demand index will jump to a four-week high. [Keep in mind that this index is seasonally adjusted, so the increase I'm talking about has nothing to do with the fact that we are moving into May.] I am a bit skeptical that the index will be able to sustain this higher level all the way through the holiday (because of the lack of forward bookings in the near term). But what the hell…. let's say that it does. In that case, if fed cattle slaughter climbs to 535,000 in the meantime, then the combination of supply and demand yields a pre-Memorial Day peak at about $225 (on a weekly average basis, that is). It's an odd place for a top, according to the chart. But I'm just sayin'…

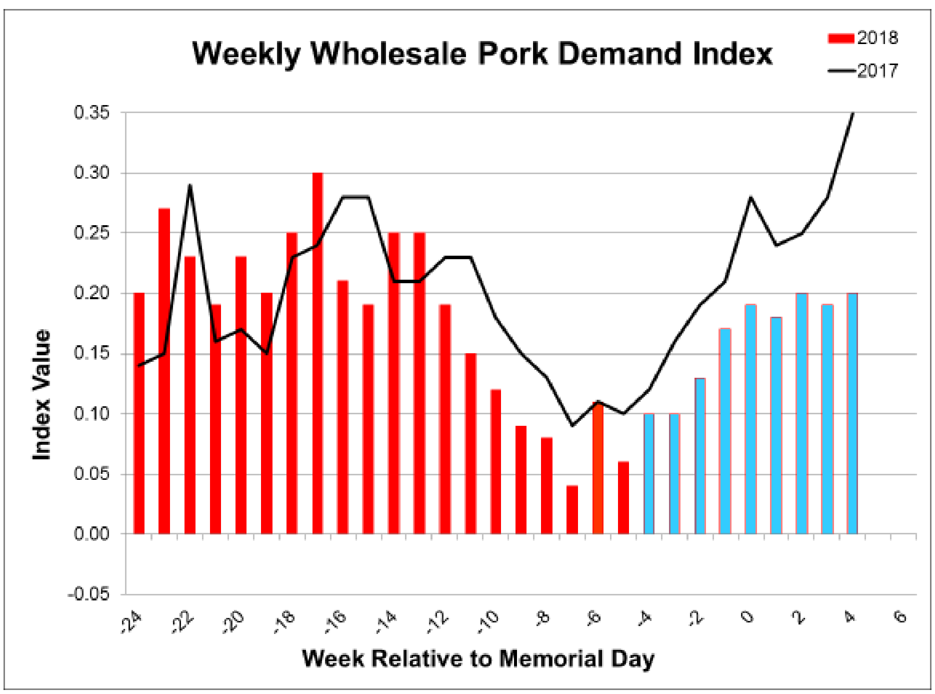


The demand prospects look quite a bit better for June. What has happened, of course, is that "out-front" asking prices generally have dropped, and buyers have responded. With steer and heifer kills likely averaging near 535,000 per week in June, it is essential that get a sizeable amount of product pre-sold in order to prevent a serious backlog in the spot market.

Notice how sharply the forward booking activity tailed off last year, for delivery windows between early June and the end of July. In retrospect (the vantage point from which I am brilliant), it is no wonder that the combined cutout value lost $40 per cwt during that time frame. I suspect that this year's pattern will more closely emulate that of 2016; but that all depends on how high prices will become in June, and how aggressively packers are willing to price product "out front" for delivery in July and early August. Presently, I am guessing that the combined cutout value will average near $220 in June.

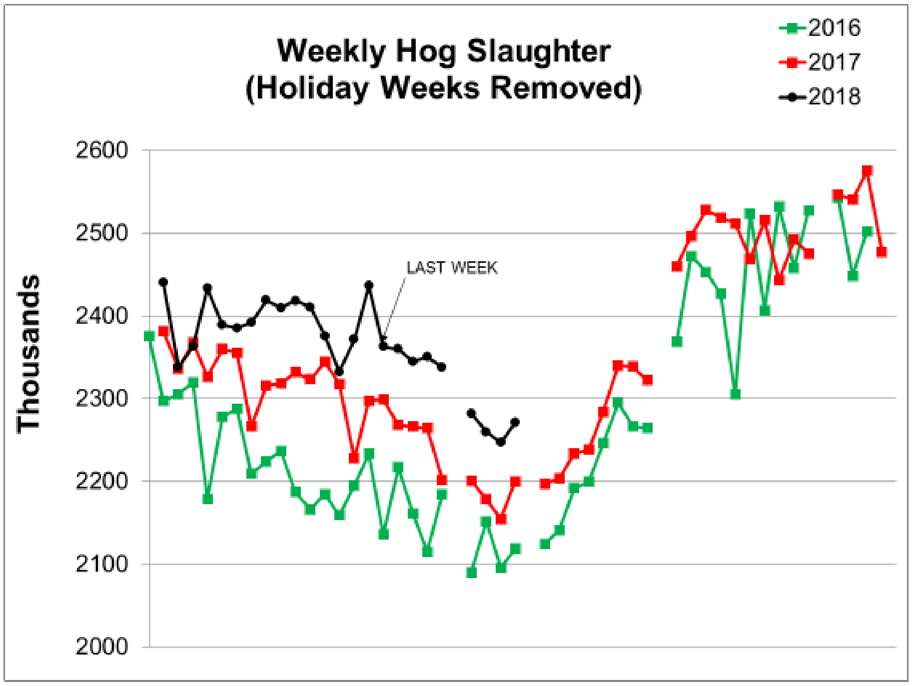
Finally, I don't want to leave the subject without mentioning that the best values on the Beef Menu right now seem to be the Select short loins and strips, along with ball tips of both "flavors". Select-grade short loins, at $4.50 per pound, are the cheapest they have been on May 1 since 2006 and are trading $1.50 below where they stood at this time last year. Select 0x1 strips, which are just above $5.00 per pound, trade at five-year lows for this date and $1.00 per pound below a year ago. Anyone who follows the ball tip market—and I do occasionally bump into someone at church or in the laundromat whose *does*—knows what I'm talking about. Enough said.

Since I relayed my opinions of the pork belly market *ad nauseam* in last week's report, I'll not spend much time discussing them today. My perception is that bellies will start to move when weekly kills drop below 2,350,000 to stay…. which should be next week. The presumed rally is not likely to meet with much resistance until prices approach $1.40 per pound. At or about that point, I would expect a wave of frozen product coming onto the market from buyers who put bellies in the freezer from $1.10 to $1.25. If I were they, I would take the first opportunity to get out from under those inventories with minimal damage. [Remember that frozen bellies are worth less than fresh in late spring and early summer.]



The short-term status of wholesale pork demand is depressed, but I cannot think of a good reason why it should not improve—and markedly so, and very soon.

I don't know what the "magic number" may be, but it is apparent that production will have to drop below a certain level and remain there before the pork cutout value will advance in earnest. If that number is 2,350,000 hogs per week, then the rally that the futures market is expecting should be underway next week. Aligning second quarter kills with USDA's fall pig crop estimate and aligning May and June slaughter with the quarterly total as objectively as I am able, I expect the pattern in weekly kills to be as shown in the picture on the next page.



Meanwhile, pork is exceptionally well-positioned to capture prominent retail feature business here in May (and beyond). I am referring mainly to loins and butts. But should hams not attract export buyers at these price levels? I would certainly think so. They are priced not far above $.50 per pound; at this time last year they stood at $.67. The last time they were this cheap in the first week of May was in 2009. Heavyweight hams are priced 16% below 72% lean trim, which is extraordinarily low. You get the idea.

I think the projections of the short-term demand index that I show on the preceding page are somewhat conservative, since they assume that seasonally adjusted wholesale demand will remain well below its first quarter peaks. But applying these demand projections with the production rates shown above yields a forecast of the cutout value just above $80 per cwt before the end of May, and up to $87 in the second half of June. Yesterday's quote was $69.16. Major resistance levels on the chart, by the way, lie at $80.27; $82.78; and $84.78.

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