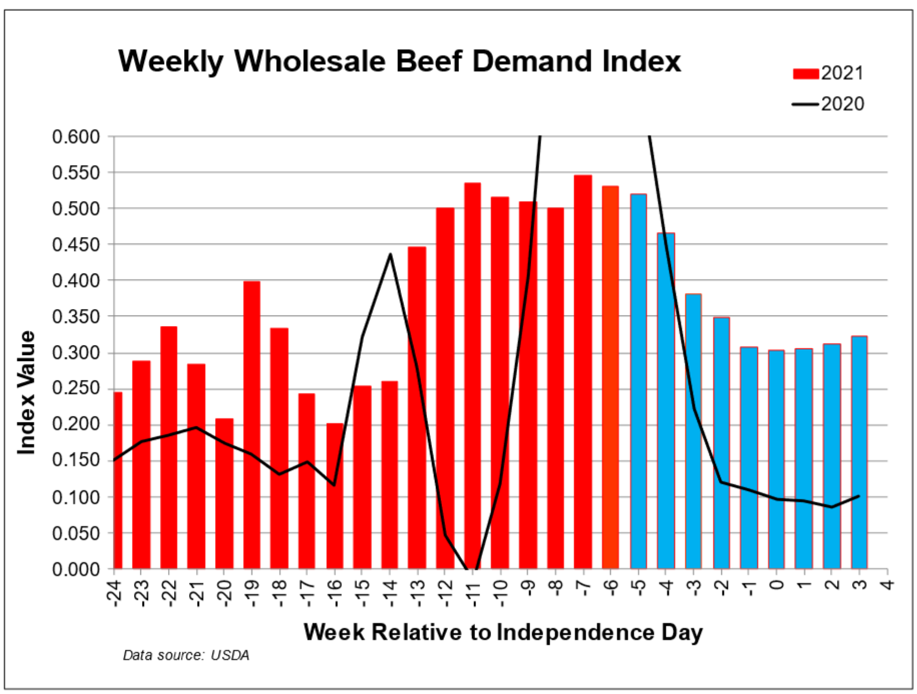
MEAT MARKETS UNDER A MICROSCOPE

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

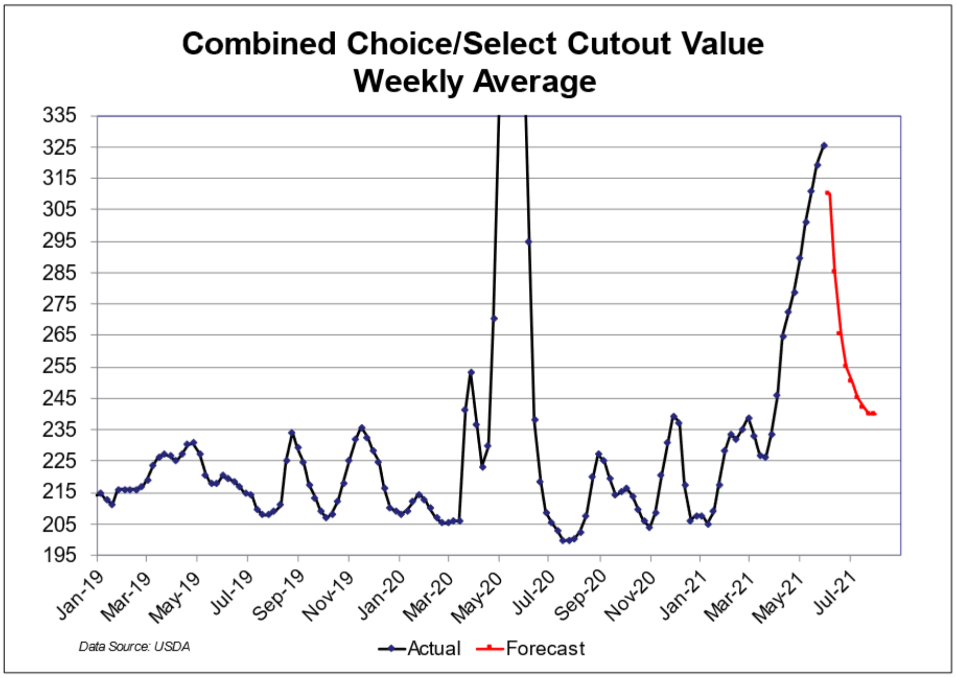
May 30, 2021

After weeks of watching both beef and pork prices outperform my expectations, it is tempting to relent and assume that there will be no setback in underlying demand—in other words, that demand will maintain its currently inflated status and merely undergo typical seasonal changes from this point forward. It is always possible, and so it is worth noting that *if* this were to be the case, then the combined Choice/Select cutout value would still move downward from here; but it would do so relatively gradually, slipping from Friday's quote of $326 per cwt to about $290 at the end of June and then into the upper $270's at the end of July. [In the current environment, a $48 decline could be described as "gradual".]

But my intuition and market sense (such as it is) tell me that the probabilities favor a steeper drop in beef prices. I refer to intuition and market sense because projections of demand are largely subjective. But it makes sense that supermarket chains should be shifting into "margin recovery mode", meaning that retail prices should be going up sharply. And it is hard for me to believe that this could happen without causing any slowdown in product movement.



Even acknowledging that there has been a major upward shift in demand, I also find it hard to believe that the seasonally adjusted demand index will never return to where it stood just two months ago. After all, the readings in February and March were, by historical standards, exceptionally strong. My projections of demand and cutout values are shown in the picture to the left and the one at the top of the next page.



Finally, I suspect that if product movement does indeed slow down materially, there will be a vacuum of sorts underneath the market, especially in the middle meats.

There are some faint but respectable signals that a downturn may be close at hand. Specifically, I notice that:

--Choice ribeyes, strips, short loins, and top butts all traded sideways last week, finishing about where they started;

--With the exception of tenderloins, the charts of Select middle meats look like they have topped out;

--Briskets showed a weakening trend over the last five trading days and were offered lower at the end of the week;

--81% lean ground beef quotes reached new highs this past week at $2.92, but the Friday-to-Friday gain amounted to only 2¢;

--While bottom round flats and shoulder clods show no clear sign of a top just yet, the rate of increase in prices has slowed significantly

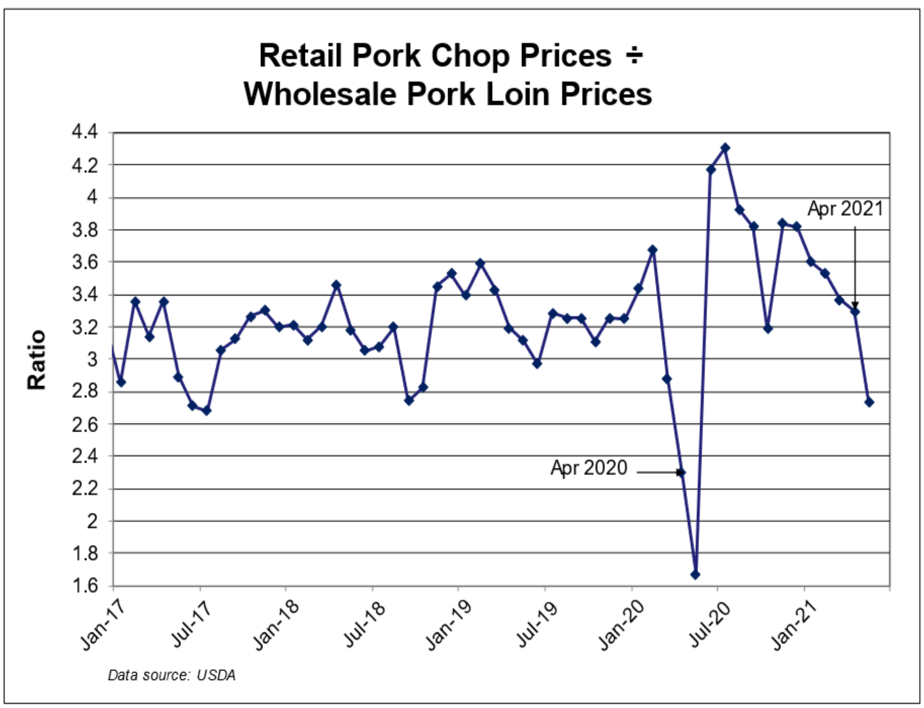
--Knuckles have leveled out, and both inside rounds and chuck rolls finished last week with a distinctly softer undertone.

If I sound like I'm searching hard for bearish signals in the beef market, it's because I *am.* We're at an important crossroads right now, and the market's behavior in the week ahead—with Memorial Day business behind us and production (presumably) returning to more normal schedules after Monday—should tell us whether my demand-side assumptions are valid.

The pork market has been not only an ego-buster but also a drain on my equity, as I have made multiple (unsuccessful) attempts to trade the futures market from the short side. You may not believe this, but to me, losing money in the market is not nearly as disconcerting as my failure to fully understand what's going on. I mean, of *course* it has been demand that has pushed the cutout value so high….but it has been difficult to precisely identify the source of this demand. Without knowing how the market got to where it is today, it is impossible to discern whether this extraordinary condition is something we will have to deal with throughout the summer, or whether it is a "house of cards".

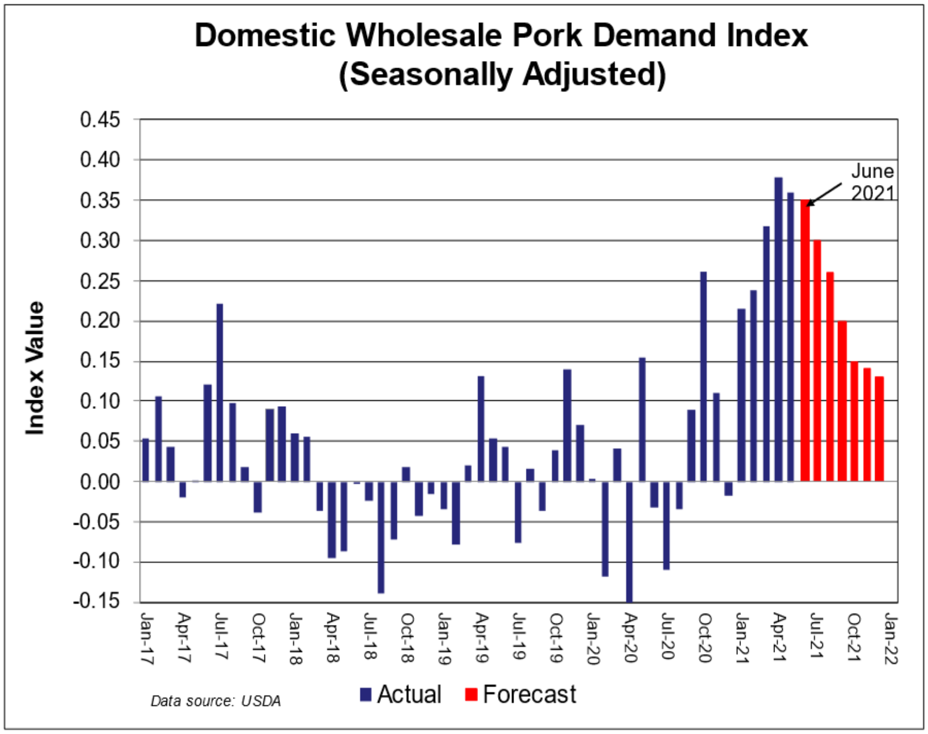
In retrospect, it makes sense to me that demand for pork, like all proteins, has received a giant boost from the various economic stimulus programs that have been put in place in the last few months. The rather sudden injection of cash into the system has allowed consumers to pay higher prices for meat in the grocery store, and I think this might be the primary reason why demand has held up as well as it has. The recovery in foodservice business has also been a factor, although this pertains mostly to bacon, ham, and back ribs. But as I touched on a bit earlier, there must be a point at which higher retail prices begin to adversely affect product movement through supermarket channels. When that point is reached, demand at the wholesale level will slacken.

My guess is that in the case of loins, butts, and spareribs, that point could be close. These items are driven mainly by supermarket business, and retail margins in the fresh pork category (along with bacon) were squeezed pretty hard in May. In the graph below, the final data point is the comparison of April retail prices with May wholesale prices in the pork chop subcategory. The retail price series reported by the Commerce Department does not permit an equivalent comparison pertaining to butts or ribs, but it probably looks similar.



The implication is that retail prices of fresh pork cuts will jump—not to the same extent as beef prices, but enough to make a difference—and it probably will not take very long for supermarket chains to bring their margins back into a targeted range. Unless wholesale costs come down materially, it would take an increase of roughly 50¢ per pound in retail prices to bring the ratio in the picture above back up to 3.10.

It is common for loins, butts, and spareribs to set back after Memorial Day business is priced, and I had expected them to do so *last* week….but it didn't really happen. Bone-in loins did lose about a nickel per pound and spareribs showed a token decline, but boneless loins and butts didn't budge. It goes without saying that I will be surprised if this family of products does not fall sharply in the week ahead.



Purely out of a vague respect for the market's resilience up to this point, I bumped up my projection of the seasonally adjusted demand index, such that it shows virtually no change from May to June. It is a somewhat optimistic expectation, I think. And yet, it still, it points to an average pork cutout value of $118 per cwt in June, about $8 below Friday's quote. I am assuming that there will be some demand erosion by July (relative to the seasonal norm, I mean), resulting in an average cutout value of $115 at that time. But I should point out that even the lower demand index projection for July would be the second strongest on record for that month. These price forecasts are based on average weekly kills of 2,400,000 in the non-holiday weeks of June and 2,370,000 in July as indicated by the winter pig crop estimate.

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