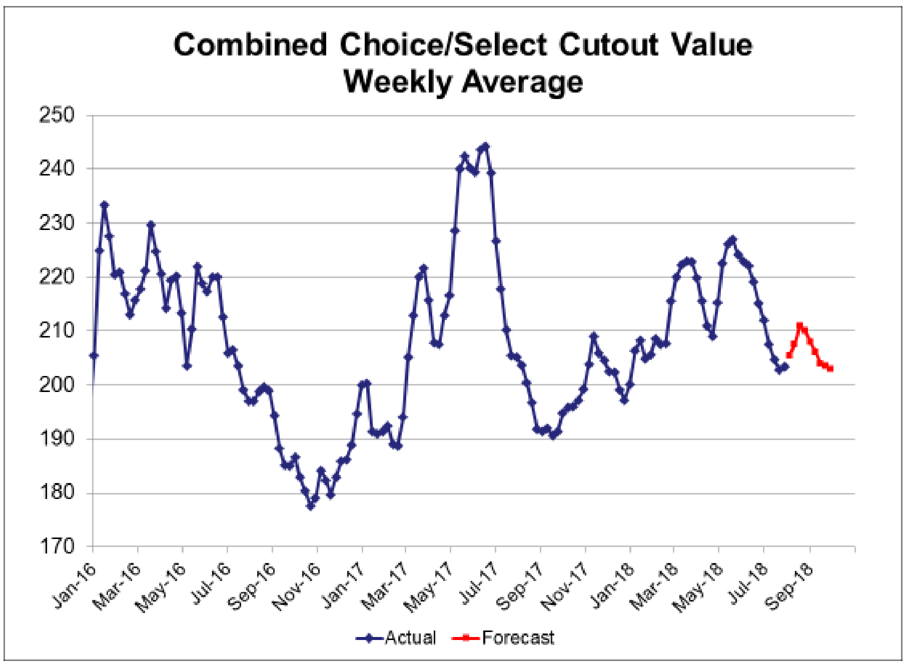
MEAT MARKETS
UNDER A MICROSCOPE

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

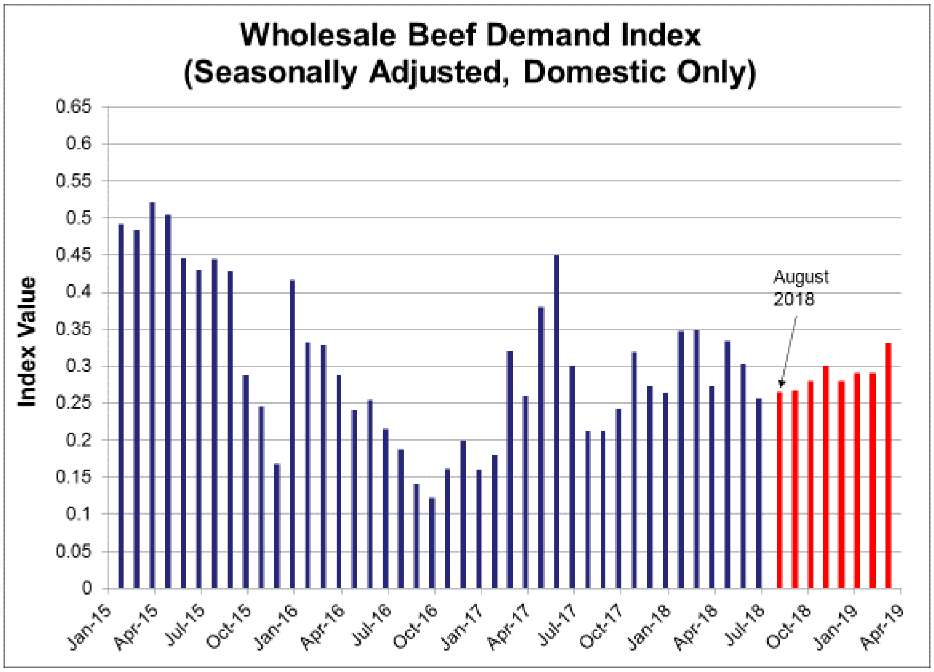
August 1, 2018

The combined Choice/Select cutout value made an important low on July 16 ($202.15 per cwt) which likely will be revisited in September, but not penetrated until November or December. In the absence of any pronounced gyrations in demand—and my assumption is that there will be none for a while—the cutout will spend most of the next four months between $202 and $210 per cwt. A look at the weekly chart should make it obvious how these parameters are derived:



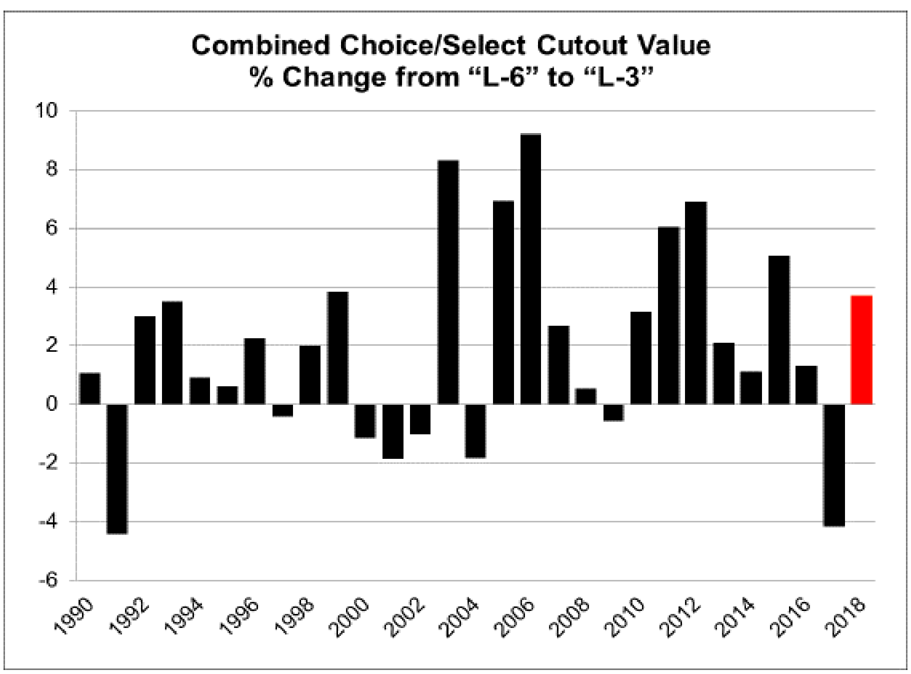
The $210 area has been a significant one since last fall, and is likely to be the approximate location of the August peak (the chart at left extends my forecasts through the end of September). And a $10 rally such as I am proposing would solidify the support at $202. There *will* be a rally into an August peak, won't there?

Before I address this question, I should explain my assumption that there will be no great surges or droughts in wholesale beef demand within the next three months or so. My reasoning is pretty simple. Not since May has there been such a deviation from the seasonal norm; the retraction since then has left the seasonally adjusted demand index in midrange territory, implying that prices now stand in neither "demand-building" nor "demand rationing" mode. To express this in English, the beef market is currently in pretty good balance, and some sort of mild shock will be required to throw it out of balance once again. Retail prices and retail margins are sustainable at current levels.



OK, so why should we *not* expect a substantial rally in cutout values between now and Labor Day? Clearly, the market has demonstrated a pronounced tendency to appreciate over the upcoming three-week period, as I show in the second picture on this page. In this graph, "L-3" represents the week ending August 18, three weeks prior to Labor Day.

The 3.7% gain from last week's average that I am anticipating has been matched or exceeded nine times in the last 25 years; only seven times was the market no better in mid-August than it was in the final week of July.



I must admit that I cannot readily identify a common thread among the "underperforming" years. [By "readily" I mean something that can be accomplished in the time it takes to eat a Hershey bar.] But there has been a considerable amount of meat booked for delivery through the middle of August, and so there is no indication that demand at the wholesale level would suddenly slump below par. And if demand were to follow a perfectly normal path, then an average weekly steer and heifer kill of slightly more than 500,000 would align with an average cutout value of $208-something for the month, and a peak of about $211. At the current rate of 510,000, the upside target would be somewhat lower—about $210 per cwt.

What, then, would it take to get the combined cutout value up to $210 within three weeks? Here are my ideas. Bottom sirloin cuts and flank steaks are not included on the list because I do not expect these to show any material change:

	W/E 8/18	7/31 Quote
CH Bnls Ribeyes	735	698
CH Clods	220	215
CH Chuck Rolls	300	292
CH 0x1 Strips	540	528
CH Top Butts	340	326
CH Tenderloins	935	915
CH Peeled Knuckles	250	239
CH XT Inside Rounds	225	213
CH Btm Round Flats	220	203
CH Eye of Round	230	209
CH Briskets	235	231
50% Lean Trim	70	72

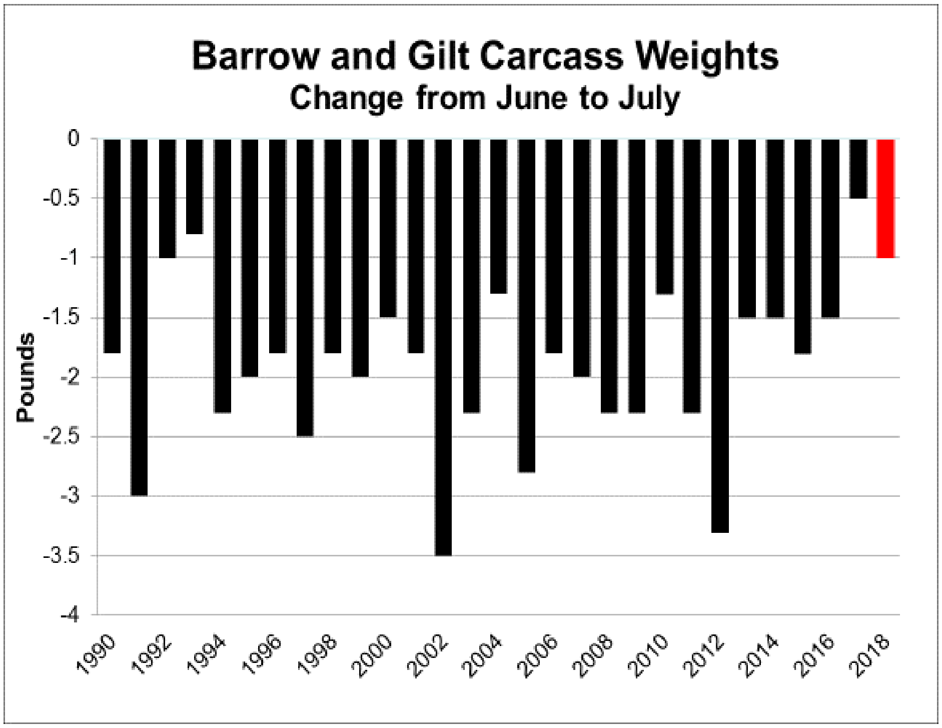
	W/E 8/18	7/31 Quote
SL Bnls Ribeyes	650	616
SL Clods	220	217
SL Chuck Rolls	295	287
SL 0x1 Strips	534	534
SL Top Butts	335	326
SL Tenderloins	885	860
SL Peeled Knuckles	250	250
SL XT Inside Rounds	225	210
SL Btm Round Flats	220	219
SL Eye of Round	230	212
SL Briskets	235	222
81% Lean Grind	185	167

Hmmm…It looks like a bit of stretch for certain items, doesn't it? That makes the resistance in the combined cutout value around $210 look pretty stiff. Let's get out of here before I find something that contradicts my opening logic.

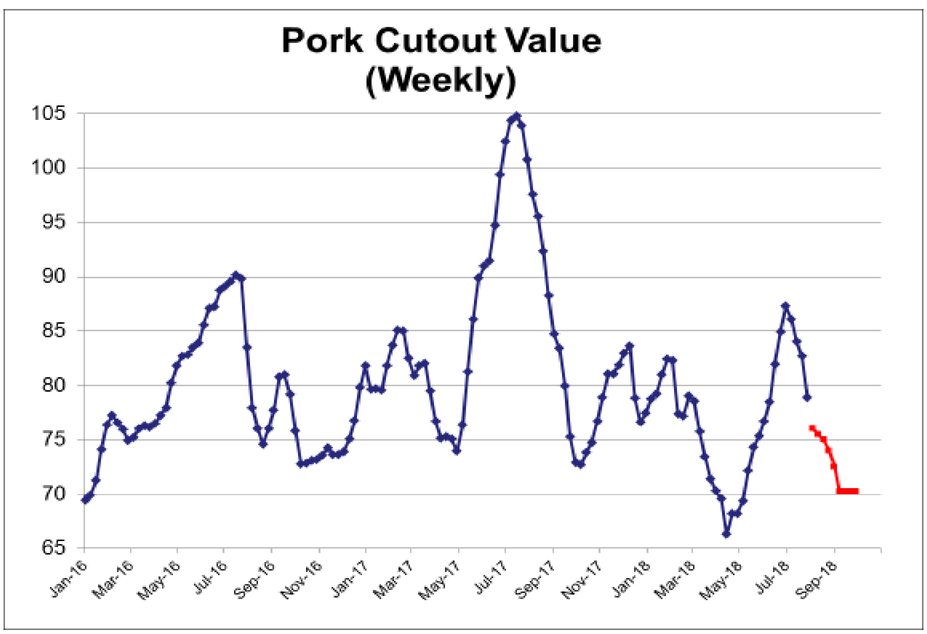
Packers must have carefully planned how they would work around all of the maintenance-related "down time" that has caused such wild fluctuations in weekly hog slaughter. Pre-scheduled production breaks are a normal occurrence for this time of year, because this is often when hog supplies are tightest…but I've never seen anything like *this* before.

I'm trying to look past the short-term and focus on the broader picture. When it was all said and done, hog slaughter was up 1.4% from a year earlier. This followed a 3.6% increase in June and a 3.5% increase in May. From this angle, it appears that kills were a bit light relative to the hog supply; and carcass weight data tend to support that notion, as barrow and gilt weights declined slightly less from June to July than they normally do (based on actual data for the first half of July and USDA's daily LM_HG201 report for the second half). I show this picture on the next page.

But I don't want to make a big deal out of that story. What I'm wondering is whether slaughter projections for August and September should be adjusted upward because of the smaller-than-anticipated kill in July, and the answer I come up with is….yes, probably so. The justification for raising the supply expectations through the balance of summer is that to do so would bring the third quarter kill more in line with the winter pig crop; and my guess that hog producers will move animals aggressively in view of overwhelmingly bearish price expectations and "barn space" considerations. The drawback is that raising kill projections for August and September would make the July total extremely small in relation to the rest of the quarter—the second lowest, in fact, since 1991. I'm placing this consequence in the back seat for now.



And so, it looks like we may be headed for a steep increase in production, from this week's probable total of 2,335,000 to 2,450,000 in the second half of August and nearly 2,600,000 in the second half of September. The market may have a difficult time absorbing an increase of that magnitude, such that the demand readings for August may turn out to be very weak, down sharply from July.



Thus, the pork cutout value appears to be on a fast track to $70 per cwt. My guess at this juncture is that it will reach that level in the first week of September, and then stabilize for several weeks. This assumes that after tumbling in August, demand for pork at the wholesale level will undergo normal seasonal changes during September and October. I'm keeping in mind that at some point, the cheap pork prices we are now witnessing—and have been for some time now—will lead to a substantial recovery in demand. It always happens. The challenge is to identify *when*….

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.