MEAT MARKETS
UNDER A MICROSCOPE

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

September 19, 2018

Over the past two months, the combined Choice/Select cutout value has loosely followed its typical seasonal course—hitting bottom in the second half of July; rallying to a peak in mid-August; and returning to the previous low here in mid-September. As I said, *loosely*. Why would it not remain on a typical seasonal path for a while? According to the 15-year history, that would place the next bottom it in the fourth week after Labor Day, 1.9% (a little less than $4 per cwt) below the current quote.

As best I can tell, the list of products with material downside potential in the near term is pretty short. It is comprised of Choice strips and short loins; Select ribeyes; and top butts of both "flavors". Perhaps I should shift to the format of *The Daily Racing Form*.

Chuck Rolls: It makes sense that there will be persistently strong support from Korean demand which, as you probably already know, is running far ahead of last year's pace. The 15-year seasonal track record between now and the middle of October shows an upward bias. In each of the last two years, this market traded northward of $3.00 per pound early October.

Shoulder Clods: The seasonal tendency is toward weaker prices over the next three to four weeks; but really, now, how much downside potential can there be from $2.04 (Tuesday quote)?

Choice Boneless Ribeyes: Prices are record high for this time of year, but this is one item in which a strong economy could show its influence. There is a distinctly upward historical bias between now and mid-October. If there were to be a post-Labor Day slump, wouldn't it have happened by now? Last year, it started out the month of October at $7.25 and finished above $8.00.

Briskets: This market has an historical tendency to lose a little bit of ground over the next three to four weeks, but it has already come down roughly 30¢ per pound since Labor Day. The post-Independence Day low was $2.25, and the current quote is near $2.30.

Ground Beef: The simple average price of 81% lean, 73% lean, and ground chuck has retraced roughly half the rally from $1.50 to $1.90 that occurred from the middle of July to the middle of August. It traded as low as $155 in early October 2017, but production should be smaller and demand stronger this time around. Unlike the beef market as a whole, retail ground beef prices stand below a year ago. The near-term seasonal track record, though, is lousy. Maybe a steady go is the best bet.

50% Lean Trim: They have increased more often than decreased over the upcoming three-week period, and 50¢ per pound is an obvious support level. Why would one think that it's going below that mark? One reason would be because this market came into October below 50¢ in each of the past 3 years….is there any other reason? It's worth noting that the "50's" also traded up to 75¢ toward the end of October 2017.

Choice 0x1 Short Loins: These traded as low as $4.25 in September 2017, which turned out to be the low for the rest of the year. But who says they have to match that level again this time? Currently at $4.70, they are probably "only" 20¢ from the bottom.

Choice 0x1 Strips: Considering that they traded down to $5.20 in early August, it seems a good bet that this number is within reach within the next few weeks; that would make for a 50¢ per pound decline from the current quote. This market shows a seasonally downward bias over next 3 weeks, of course….but it's not as pronounced as you might think.

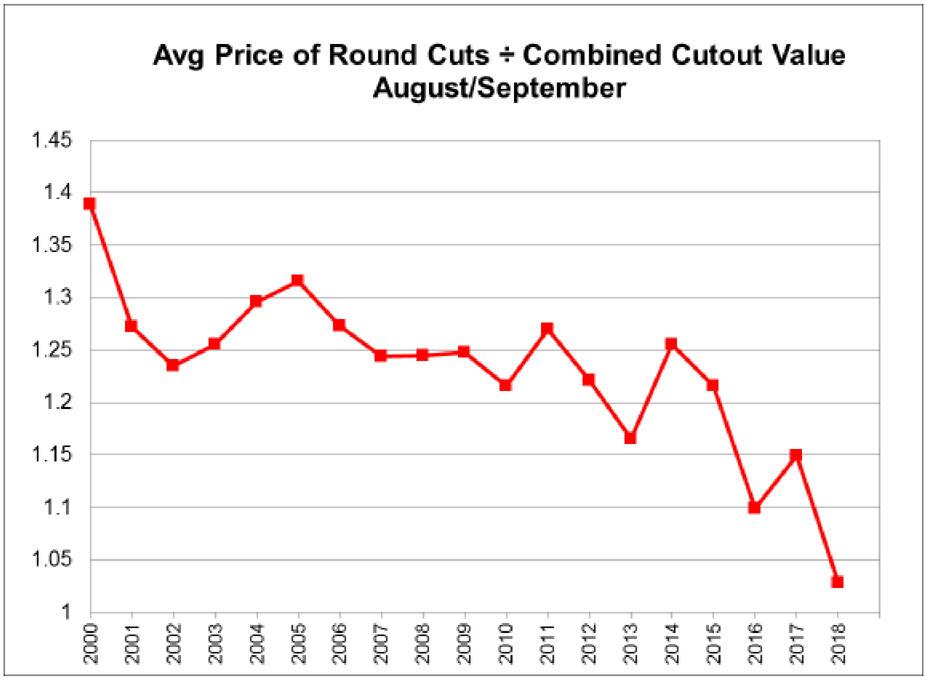
Choice Top Butts: The seasonal track record is dismal, with prices having gained ground only twice in the last 15 years between now and mid-October. Last fall's low was $2.50, but I'm not betting on anything that low this time around. Top butts are a sleeper and the sirloin steak is likely to emerge in supermarket ads before long. My guess is that a 10-15¢ decline would catch whatever seasonal weakness remains.

Select Boneless Ribeyes: Prices are record high for this time of year and almost $1.00 per pound higher than a year ago. The seasonal history shows no bias in either direction. This market is nearly matching its May peak, so there is plenty of room on the chart for a setback. As a buyer, I would be circumspect.

Select 0x1 Short Loins: This one is situated at $4.00 per pound, a price that held up the mkt in September-October 2017. Supply and demand should be able to strike a balance without having to push below that support.

Select 0x1 Strips: Same story as the Select short loins. Minimal downside potential in the near term.

I've saved the round cuts for last because they are so cheap relative to rest of beef market. I show this in the picture on the next page. The simple average price of the four major round cuts stands at $2.13 per pound and has been sitting at that price for six weeks; last year at this time it was $2.25. Round meat is exceptionally well-positioned to capture supermarket features through October. I propose that the round complex will dictate when the cutout bottoms and how far it rallies in October (I'm betting that it will).



The pork market is clearly in a state of flux because of the now week-long shutdown of packing plants in North Carolina. Last week's kill of 2,315,000 was only 100,000 above the preceding holiday week (the smallest increase on record), which in turn was only 1% bigger than a year earlier. This week's total will also be curtailed, unless packers load up on the Saturday kill.

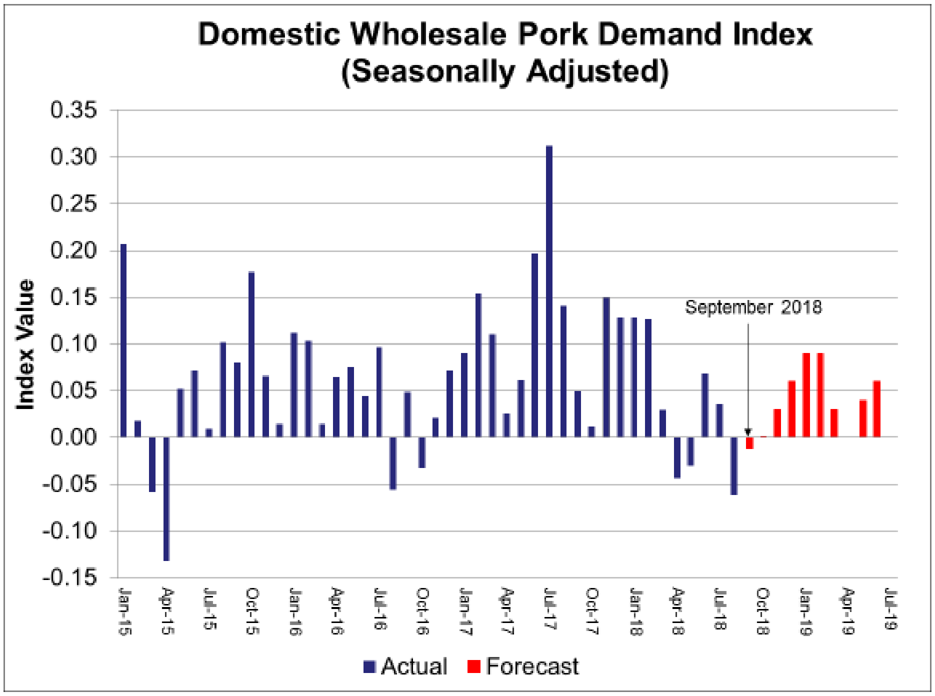
Surely, Smithfield Foods made preparations for the temporary shutdown as best it could, but I seriously doubt that the pork cutout value would have jumped as much as it has--$9.72 per cwt over the last seven business days—without the sharp production cutback. I point to the fact that the price increases have been across the board, with all components showing substantial price gains….and I keep in mind that demand for bellies, trimmings, boneless picnics and, to a lesser degree, hams is inelastic in the short run.

If that is indeed the case, then it stands to reason that pork prices will recede as plant production schedules return to normal. Meanwhile, the North Carolina Department of Agriculture and Consumer Services estimates pig death losses at 5,500 head, a number that is insignificant to the pork market.

And so I expect that the market will eventually seek out the same equilibrium price levels as it would have in the absence of the Tropical Storm. Why would it not? The total hog supply has not been significantly altered, nor have the prospects for pork demand due to the price increases that have occurred over the past week.

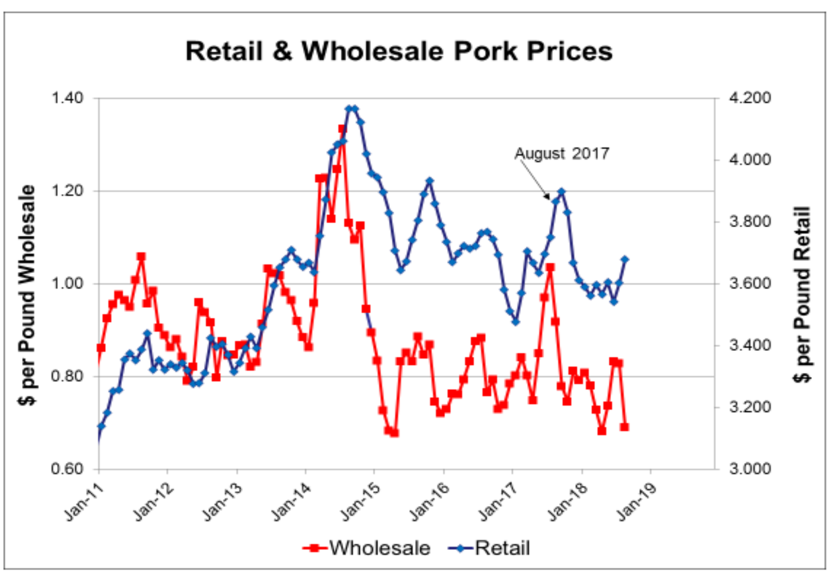
With weekly hog slaughter averaging near 2.6 million over the next six weeks, I look for the cutout value to average something like $72 per cwt in October. It sounds kind of low compared with Tuesday's quote of $77.57, but it's about halfway back to the bottom that was established on August 24. I do not expect either bellies or hams to return to their trade levels of late August.

The $72 forecast of the October cutout value includes the assumption that wholesale pork demand is legitimately recovering to moderate levels, from the depressed status that it held in August. In the first picture on the next page the first red bar represents September 2018.



I use the term "legitimately" to mean that some sort of appreciation in pork prices would have happened anyway, even without the disruption in supply. Indeed, the cutout value had already bounced $3.67 per cwt from its bottom prior to last week. Through sustained low prices, the market was in a "demand-building" mode throughout the month of August, and steep discounts in October and December futures contracts fed expectations of even lower prices in the fall. One way or another, such conditions result in aggressive promotions (in both supermarket and restaurant sectors) and lower consumer-level prices, which in turn speed up demand in the wholesale market. I don't know how much demand will recover by October; my guesses shown in the chart may be too conservative. However, I *am* building into the equation one of the greatest August-to-October increases in wholesale pork demand on record.

As I show in the final picture, retail pork prices appear to be set up for a decline in the months ahead—it is probably has begun by now—because retail margins are very wide. In August, they already stood 19¢ per pound, or 5%, below a year earlier.



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