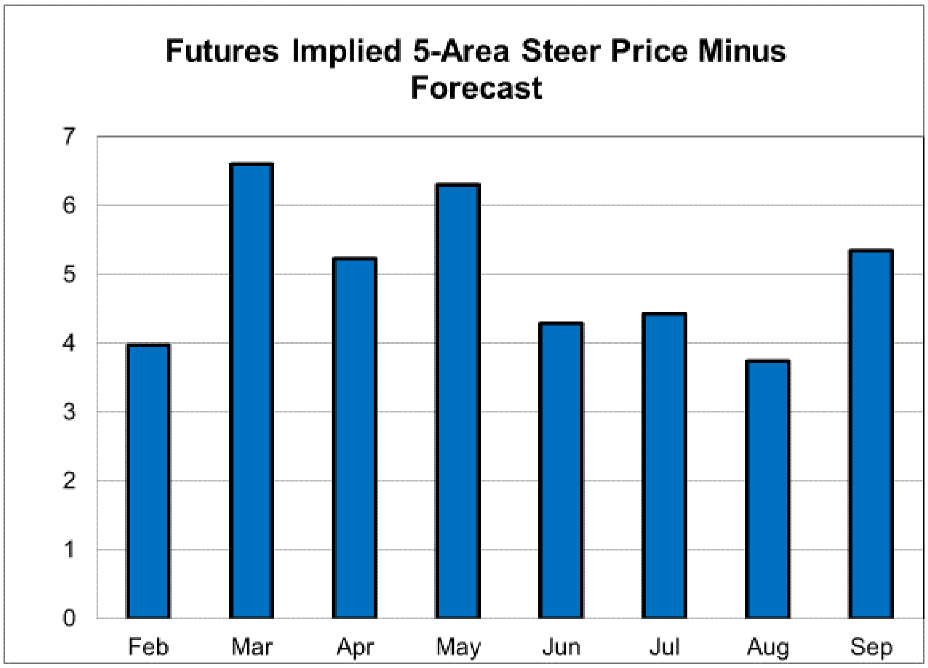
Trading Cattle
…. from a meat market perspective
A commentary by Kevin Bost

January 29, 2018



The April, June, and August contracts are equally overvalued, based on what I *think* I know at this juncture, and so I am interested in—but have yet no commitment to—the short side of one of these. I have no bet on the table at present because these contracts are not greatly overvalued—just moderately so.

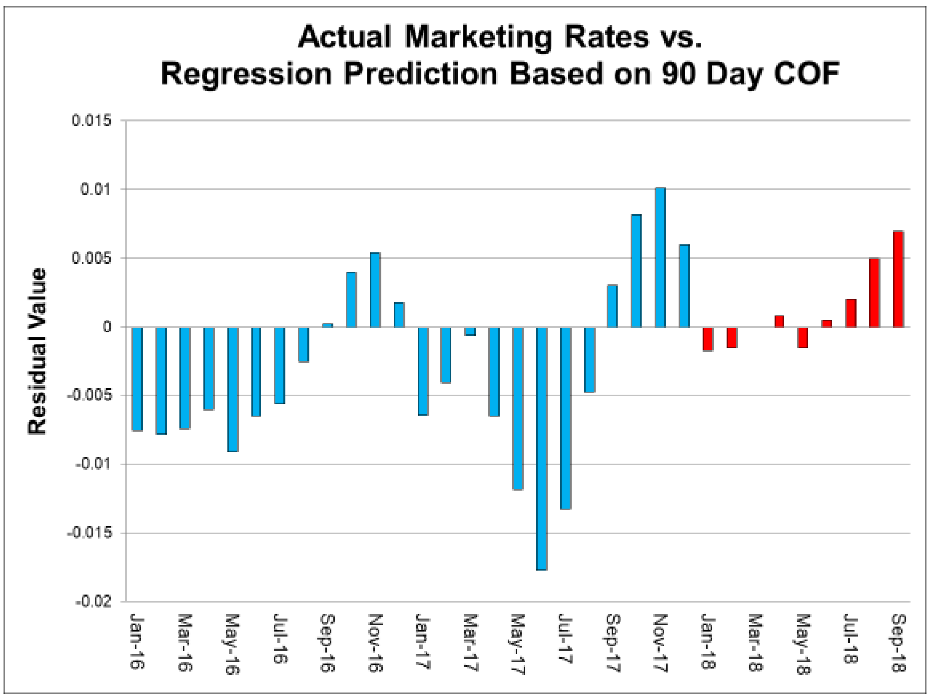
Also, this past week's cash cattle trade ($126-$127 per cwt) was a bit of an eye-opener. The chart of the Five Area Weighted Average Steer price looks bullish, with no discernible resistance this side of $130….and assigning "major resistance" status even to that price level requires some imagination. And so, from that angle alone, the market tells me to be cautious about entering the short side.

The rather odd price behavior at the end of last week did nothing to clear up the picture. Thursday's big outside range/reversal was decidedly bearish, but Friday's strong recovery neutralized the whole thing. Whichever way the market decides to move through Thursday's high ($126.30 in the April contract) or Friday's low ($122.02) should be revealing. I am content to wait for that to happen. A bullish breakout would seem to put the contract highs into play, while a bearish breakout would leave a sort of vacuum between $122 and $118. The market is trying the upper end this morning. Should it be successful, then I would plan to establish an outright short position somewhere in the $129-$130 range. I have to remind myself that if such an opportunity is to avail itself, April futures might very well be trading at a par with the cash market.

But would it be better to be short of the April contract when the time comes, or short of the June contract? The equivalent entry point in June cattle would be in the $120-$121 range. Currently, at $9.00 per cwt, the premium of April over June futures is historically wide. The widest it has ever averaged during the month of February is $10.47. Viewed from this angle, the April contract might be the better of the two for a short-side bet. Logically, the June contract would be better-shielded from a surprising round of strength in the cash market; but if the cash market is trading $130 at the time, then this may not be so much of a consideration.

There is another nebulously bullish possibility in the works, and that is the chance that the market could be transitioning into a period of slower marketing rates. It's kind of difficult to demonstrate this point graphically, but the picture below is my attempt.

Up to this point, and for the last four months, marketing rates have been rather aggressive, as measured by the actual rate vs. the rate predicted by the inventory of cattle on feed 90 days or longer. [There is a very strong, inverse correlation between the two variables.] A positive residual value falls in the "aggressive" category, and a negative residual value falls into the "slow" category. Here in January (represented by the first red bar), it is apparent that the residual value has dropped barely into negative territory. My slaughter projections assume near-zero residuals through June, and a return to positive residuals in the third quarter.



Expressed in English, there is emerging evidence that cattle feeders might now be a bit more inclined to hold cattle off the market than they were in the fall. The motion makes sense, as long as futures prices retain some degree of optimism and costs of gain remain low. It's probably too early to make the call, but this would naturally be bullish of the near-term market and bearish of the back end.

Otherwise, the beef market has received temporary support, first from last week's weather-shortened kills, and now in response to surprisingly higher cattle costs. I doubt that this is sustainable, because the February slump in demand looks like it will be more pronounced than usual—this notion based on the unimpressive forward booking volumes for February delivery. Once this temporary stimulation has passed, cutout values are likely to recede, as they normally do in February. If this happens, then packers, whose margins have been pared back considerably, will be keen to hold production schedules down and bring cattle costs down with them.

Forecasts:

	Feb	Mar	Apr	May*	Jun	Jul*
Avg Weekly Cattle Sltr	588,000	602,000	606,000	635,000	646,000	618,000
Year Ago	581,400	596,800	599,600	606,400	637,900	603,800
Avg Weekly Steer & Heifer Sltr	464,000	480,000	485,000	511,000	524,000	500,000
Year Ago	458,000	476,500	481,100	490,600	514,200	488,800
Avg Weekly Cow Sltr	113,000	112,000	110,000	109,000	109,000	108,000
Year Ago	114,000	110,200	107,700	104,600	111,000	104,400
Steer Carcass Weights	888	882	867	860	873	888
Year Ago	881.3	871.8	849.0	837.8	854.0	868.5
Avg Weekly Beef Prodn	486	497	493	513	527	510
Year Ago	475.6	485.5	478.6	477.6	509.6	487.6
Avg Cutout Value	$198.75	$208.00	$207.50	$210.50	$211.50	$202.00
Year Ago	$191.02	$215.06	$211.23	$238.12	$238.48	$209.64
5-Area Steers	$122.00	$123.00	$123.00	$118.50	$114.50	$112.00
Year Ago	$120.62	$127.40	$130.04	$136.78	$126.59	$118.41

**Includes holiday-shortened weeks*

Trading Cattle is published weekly by Procurement Strategies Inc., 99 Gromer Road, Elgin IL 60120. For subscription information, please contact Kevin Bost at (847) 212-7523 (cell) or (224) 227-6281 (office); or visit our website at www.procurementstrategiesinc.com.