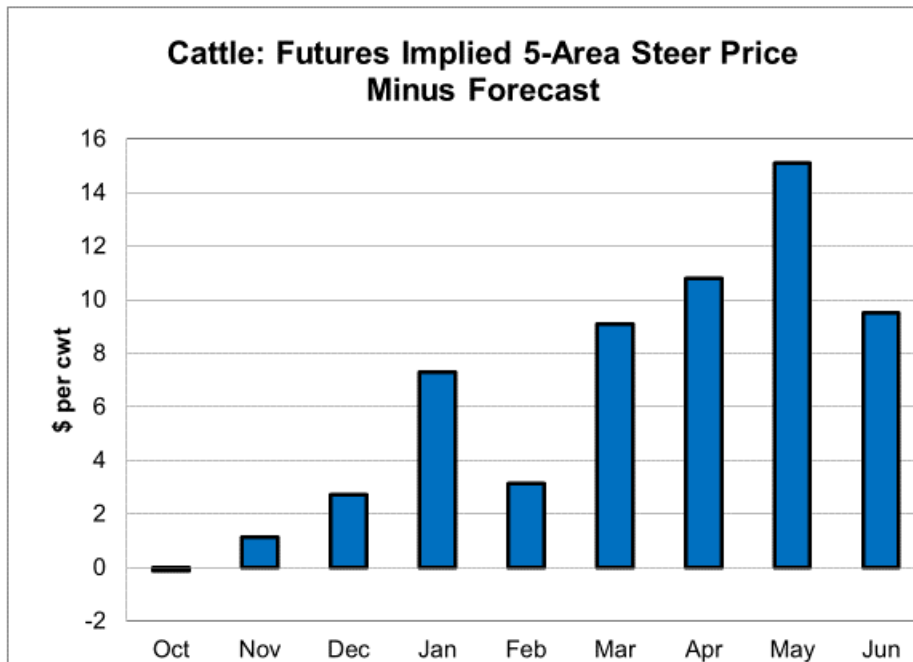


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

October 14, 2018



Having liquidated the long October / short April spread as the prospects for a strong rally in the cash market into the end of October began to fade, I am focusing on the short side of the April

contract. The central question in my mind, of course, is whether or not this contract has established its ultimate peak at \$124.92 per cwt.

I am inclined to believe that it *has* (established its peak, that is), but I would be more convinced if the market were to make an earnest attempt to resume the uptrend and then fail. So far, all we have really seen since the high was registered is a correction including just one modestly higher close in eight trading days. I am willing to sell into this “earnest attempt” that I describe, probably around \$123.00. Naturally, I will place a close-only stop above \$125.00.

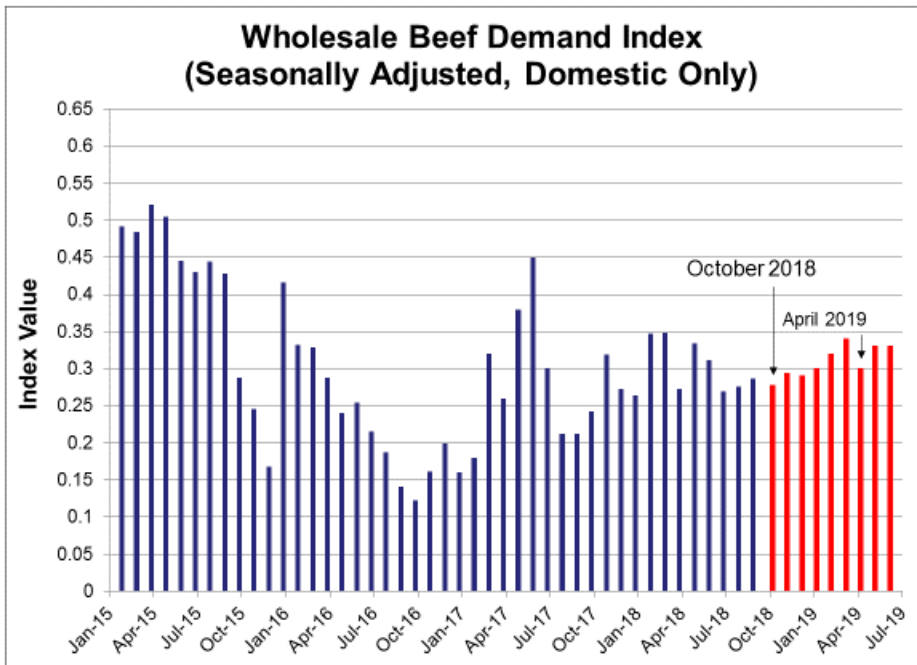
If the April contract has indeed topped out, it seems likely that it will spend some time confirming it. Although the beef market has not made any progress since the first of the month, there is a good chance that the Five Area Weighted Average Steer price—which has held basically steady for the past five weeks—will work its way up to \$116-\$117 by December 1. Thus, we probably won’t be waking up to bearish news every day for a while. Also, there is no preponderous long position that would seem to pose a threat of massive long liquidation;

commercial traders “own” the short side of the market while index funds carry the long side.

Unless I’m missing something very important in the outlook, the downside potential of the April contract is huge....enough so, in fact, that I am willing to buy April \$116 puts at \$2.00 per cwt, about where they finished on Friday. I’ll use this as a “place holder” for an outright short position, which will serve to pacify my urge to sell and perhaps prevent me from acting prematurely. You probably know what I mean by that.

But if I *am* able to sell April cattle outright at \$123.00, then I will have an initial downside target of \$118.32, which was the upper end of the big outside range/reversal of August 27. The eventual target will be something in the neighborhood of \$111.50. Yes, I’m suggesting that the April contract will return to its contract low at some point.

Really? Well, my honest, most objective forecast of the average Five Area Steer price in April is \$114.75, and in four of the last five years, April futures averaged \$2.50-\$4.00 below the cash market. Among the key variables that lead me to a cash market of \$114.75 next April, I am least confident in my projection of wholesale beef demand. My assumptions are shown below. Do they seem unreasonable? Remember that the demand index is seasonally adjusted.



Otherwise, the projection of an average weekly steer and heifer kill of 513,000 in April aligns with an April 1 inventory of cattle on feed 120 days or longer that is 20% above a year

earlier, which in turn is consistent with October placements that are up 5% and November placements that are down 1%, along with the November through March slaughter projections shown in the table below. I am also somewhat

comfortable with the assumption of a spot packer margin index of around \$200 per head, which compares with \$159 a year earlier. But even if it were to wind up at \$159 again next time around, it would raise the cash cattle forecast to \$118.50 and the ultimate futures value to about \$115....not a deal-killer.

Separately, I am considering selling December \$120 calls at \$1.50 per cwt. As you can see, it looks to me as though the December contract is worth \$113.50-\$114.00, including a futures market discount of \$.50-\$1.00 per cwt. I am betting on a relatively flat pattern in the combined cutout value through the balance of the year, ranging mainly from \$200 to \$205 per cwt. This is its current path. The options expire in eight weeks.

Forecasts:

	Nov*	Dec*	Jan*	Feb	Mar	Apr
Avg Weekly Cattle Sltr	631,000	606,000	620,000	614,000	623,000	649,000
Year Ago	625,700	593,800	595,400	594,200	600,400	620,100
Avg Weekly Steer & Heifer Sltr	491,000	475,000	482,000	480,000	487,000	513,000
Year Ago	498,600	472,600	466,400	465,800	470,400	491,300
Avg Weekly Cow Sltr	129,000	122,000	129,000	125,000	126,000	125,000
Year Ago	116,700	111,600	120,400	119,500	119,700	118,000
Steer Carcass Weights	900	900	892	885	877	862
Year Ago	902.6	902.8	892.8	884.0	877.0	861.3
Avg Weekly Beef Prodn	521	504	512	504	509	522
Year Ago	519.2	495.3	492.5	488.1	490.0	498.4
Avg Cutout Value	\$203.75	\$202.00	\$209.00	\$207.00	\$216.00	\$210.50
Year Ago	\$205.15	\$199.67	\$206.72	\$212.70	\$222.00	\$212.70
5-Area Steers	\$115.00	\$114.50	\$116.50	\$117.00	\$119.00	\$114.50
Year Ago	\$121.03	\$120.00	\$123.36	\$127.65	\$125.40	\$120.41

**Includes holiday-shortened weeks*

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