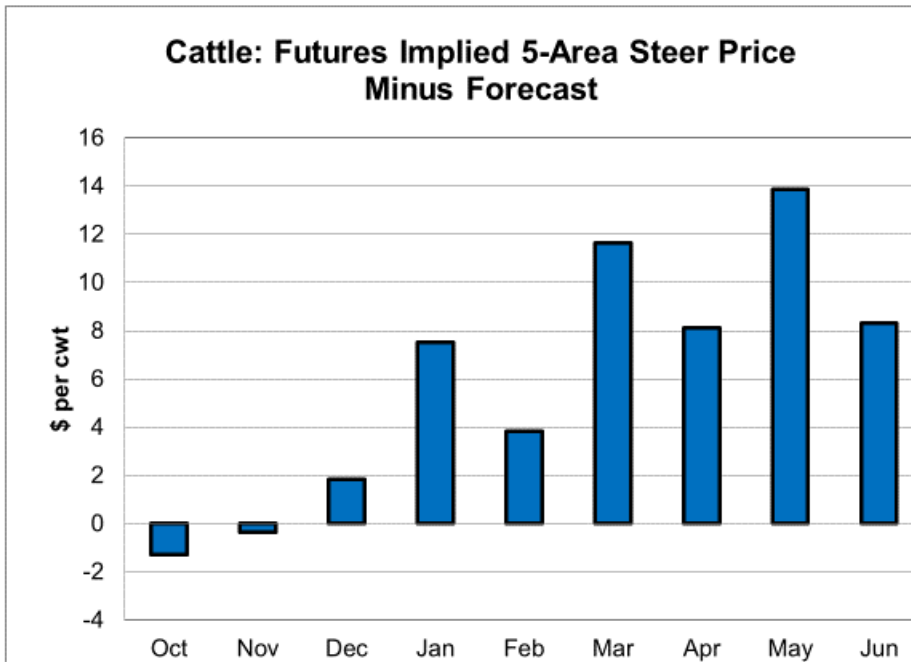


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

October 21, 2018



Currently I hold modest short positions in April cattle and the December \$120 calls. The next move I plan to make is to sell the June contract. I am choosing the June contract as the vehicle

in which to add to the short-side bet because it appears to be slightly more overvalued than April at this point, and because the technical signals of a top are more convincing. June cattle have slid through a major support level at \$114.80-\$114.90, whereas the equivalent support in the April contract (call it \$122.00) has not yet given way; plus, the June contract has dropped below its 40-day moving average.

My plan is to sell June cattle in the neighborhood of \$115.50, which is the approximate location of the ten-day moving average. I am using close-only stops at the contract highs in both cases.

We're likely to see a pretty strong rally in the cash cattle market between now and Thanksgiving. Specifically, I'm talking about a move up to \$117 in the Five Area Weighted Average Steer price. I arrive at that target by way of both a advancing beef market and a further, seasonal contraction in packer margins.

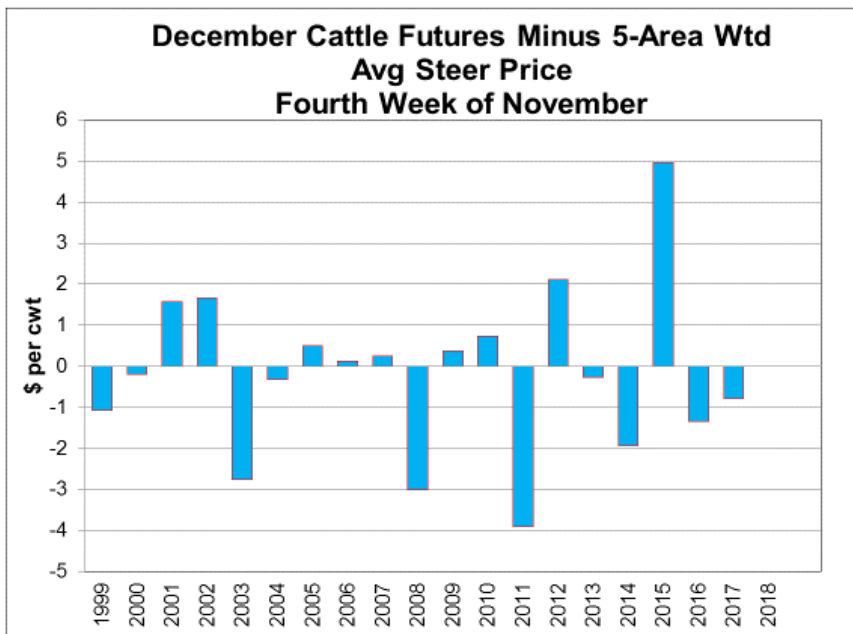
Of the contraction in packer margins, I am not highly confident. The seasonal tendency is really not consistent. In the last ten years, the spot packer margin

index has narrowed only three times—it just so happens that two of these occurrences were in 2016 and 2017. But the reading for this past week was a positive \$205 per head, far above the \$161 and \$169 in the same week in the past two years. And it is reasonable to think that we could be in for a period of slowing marketing rates as feedlots respond to low costs of gain, premiums in futures prices, and relatively high replacement prices. [This might help explain why placements were down 5% from a year earlier in September and are down again so far in October.]

As for the combined Choice/Select cutout value, it is finally getting off the ground—and distinctly so—after I had practically given up on it. Quoted Friday at \$205.21 per cwt, its chart shows no resistance between here and about \$210. It’s hard to find a single major item on the menu that has any significant downside potential within the next several weeks, while a number of items—grinds, fat trimmings, briskets, chuck rolls, and even strips/short loins—are likely to move higher.

A \$210 combined cutout value combined with a packer margin index of \$170 per head would result in a Five Area Weighted Average Steer price of \$117, which is the obviously major resistance level on the cash cattle chart.

The prospect of a “spurt” in cash cattle prices makes me a bit uneasy about my short position in the December \$120 calls, but I am willing to bet that such an advance would be accompanied by a basis shift.



In the picture to the left I show that in the fourth week of November—which is about when I expect the cash cattle market to reach its next interim peak—it is rare that the December contract holds any material premium over the cash market.

Currently, that premium stands at about \$6.50. In case you’re curious, in 2015 the cash cattle market was extremely weak between now and the end of November, losing about \$10 per cwt.

Forecasts:

	Nov*	Dec*	Jan*	Feb	Mar	Apr
Avg Weekly Cattle Sltr	631,000	607,000	622,000	613,000	625,000	642,000
Year Ago	625,700	593,800	595,400	594,200	600,400	620,100
Avg Weekly Steer & Heifer Sltr	493,000	478,000	486,000	480,000	490,000	507,000
Year Ago	498,600	472,600	466,400	465,800	470,400	491,300
Avg Weekly Cow Sltr	128,000	121,000	128,000	124,000	125,000	124,000
Year Ago	116,700	111,600	120,400	119,500	119,700	118,000
Steer Carcass Weights	902	902	894	887	879	863
Year Ago	902.6	902.8	892.8	884.0	877.0	861.3
Avg Weekly Beef Prodn	522	505	514	504	511	517
Year Ago	519.2	495.3	492.5	488.1	490.0	498.4
Avg Cutout Value	\$207.75	\$204.50	\$210.00	\$207.00	\$212.00	\$215.00
Year Ago	\$205.15	\$199.67	\$206.72	\$212.70	\$222.00	\$212.70
5-Area Steers	\$117.00	\$116.00	\$117.50	\$117.00	\$116.50	\$117.50
Year Ago	\$121.03	\$120.00	\$123.36	\$127.65	\$125.40	\$120.41

**Includes holiday-shortened weeks*

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