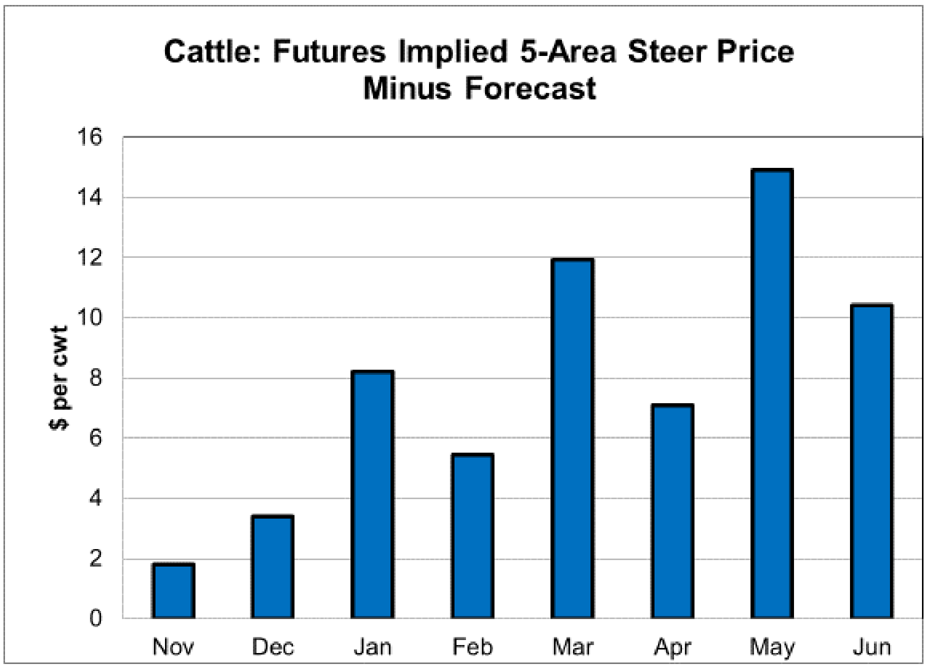
Trading Cattle
…. from a meat market perspective
A commentary by Kevin Bost

October 28, 2018



Currently I hold a moderate short position—one half in the April contract and one half in the June contract—along with a small short position in the December $120 calls.

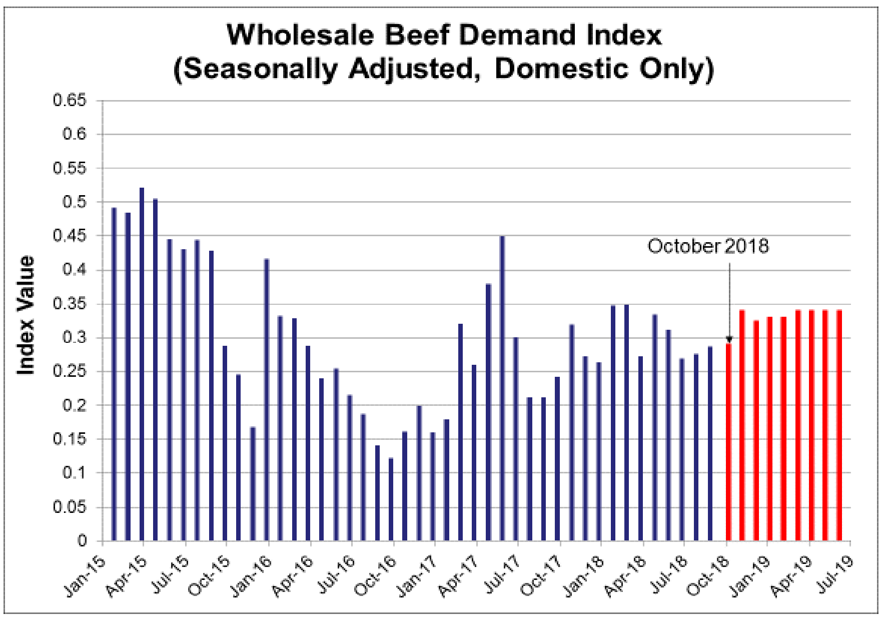
I am maintaining close-only stops at the contract highs against the outright short positions, but I intend to move the April shorts into June for reasons that should be made evident by the picture above. I plan to do so on Monday.

Although both April and June futures are still considerably overvalued, the lighter-than-expected placement activity and slightlly more bullish demand prospects cause me to raise my sights for the first half 2019 cash markets.

Preliminary counts suggest that October placements will be down significantly from a year ago, as they were in September. The figure that I am now inserting into the formula is -5%. I had originally thought that placements in both months would be above a year earlier. Accordingly, I have lowered my fed cattle slaughter projections. I am factoring in a 1% year-over-year decline in November placements, but that will be comparing against an historically large number.

The most likely explanations for the slowdown in placements include a smaller "turn-off" of yearlings from late-summer pasture (they were moved earlier due to drought in certain areas), and the combination of low costs of gain and high replacement feeder cattle costs….which, of course, would offer an incentive for feedlots to decelerate marketings and inventory turnover. The latter hypothesis makes a lot of sense, but so far it is not being confirmed by either heavier carcass weights or tighter packer margins. Anyway, my assumption is that from this point forward, feedlot marketing rates will be simply “adequate”, neither high nor low. It is the objective, default assumption.

In regard to demand, it looks as though the month of November is shaping up to be quite a bit stronger than anything we have seen since June. This notion is based on an average weekly steer and heifer kill of 495,000 next month (including the holiday week) and an average combined cutout value of $210 per cwt, about where it was quoted on Friday. My assumption is that the seasonally adjusted demand index will remain at this higher level throughout the first half of 2019—once again, the objective, default assumption:



But having made these adjustments, the April contract seems to be ultimate worth only $117 per cwt in April and $106 in June (assuming future-to-cash discounts of $3.50 and $2.50 respectively).

All well and good. But how much longer will strength in the cash cattle and beef markets push futures prices upward? Before I try to answer that, I am resolved to moving my entire short position to the June contract and maintaining a close-only stop above $117.50. But I expect that we are now entering period of substantial basis adjustment. The futures premiums are unusuall big:

Futures Minus Cash, First Week of November:

	Current	Year Ago	10-Yr Avg	Prev Record
December	$4.50	$2.00	$1.16	$7.28 (2015)
February	$9.50	$6.00	$3.29	$9.60 (2015)
April	$10.00	$4.00	$4.37	$8.65 (2015)
June	$12.00	-$4.00	-$1.20	$9.02 (1979)

The Five Area Weighted Average Steer price has finally broken out of a six-week sideways trend, and is presumably headed for it nearest major resistance area of $116.73-$117.46. If that is the best that the cash market will be able to achieve for a while, then I would *think* that the board would not be able to drive into new high territory. If cash cattle prices are to move beyond this initial area of resistance, it will require significantly tighter packer margins. And indeed they have room to tighten, given that they are historically very wide for this time of year. However, the rally in cutout values will be three weeks old in the week ahead, and the Choice cutout value is within $1 per cwt of its August peak….a likely place for a temporary top. Finally, I'll add that from the third week prior to Thanksgiving to the week prior to Thanksgiving, the combined Choice/Select cutout has lost ground in six of the last nine years.

Forecasts:

	Nov*	Dec*	Jan*	Feb	Mar	Apr
Avg Weekly Cattle Sltr	633,000	605,000	618,000	610,000	624,000	641,000
Year Ago	625,700	593,800	595,400	594,200	600,400	620,100
Avg Weekly Steer & Heifer Sltr	495,000	475,000	482,000	478,000	489,000	507,000
Year Ago	498,600	472,600	466,400	465,800	470,400	491,300
Avg Weekly Cow Sltr	127,000	120,000	127,000	123,000	124,000	123,000
Year Ago	116,700	111,600	120,400	119,500	119,700	118,000
Steer Carcass Weights	899	899	891	884	876	860
Year Ago	902.6	902.8	892.8	884.0	877.0	861.3
Avg Weekly Beef Prodn	522	501	508	500	509	515
Year Ago	519.2	495.3	492.5	488.1	490.0	498.4
Avg Cutout Value	$210.25	$208.00	$214.50	$209.50	$216.00	$219.00
Year Ago	$205.15	$199.67	$206.72	$212.70	$222.00	$212.70
5-Area Steers	$116.50	$116.00	$118.50	$117.50	$118.50	$120.50
Year Ago	$121.03	$120.00	$123.36	$127.65	$125.40	$120.41

**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; or visit our website at www.procurementstrategiesinc.com.

Information herein is derived from sources believed to be reliable, with no guarantee to its accuracy or completeness. There is a substantial risk of loss in trading futures and options especially when not hedged against a cash position. Opinions expressed are subject to change without notice. Each investor must consider whether this is a suitable investment. All funds committed should be risk capital. Past performance is not necessarily indicative of future results.