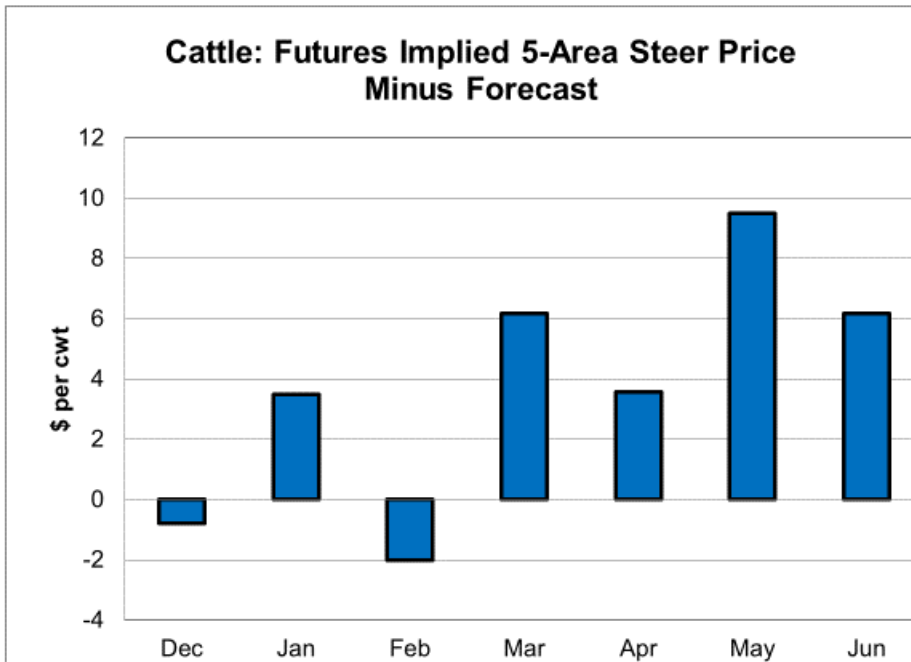


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

November 17, 2018

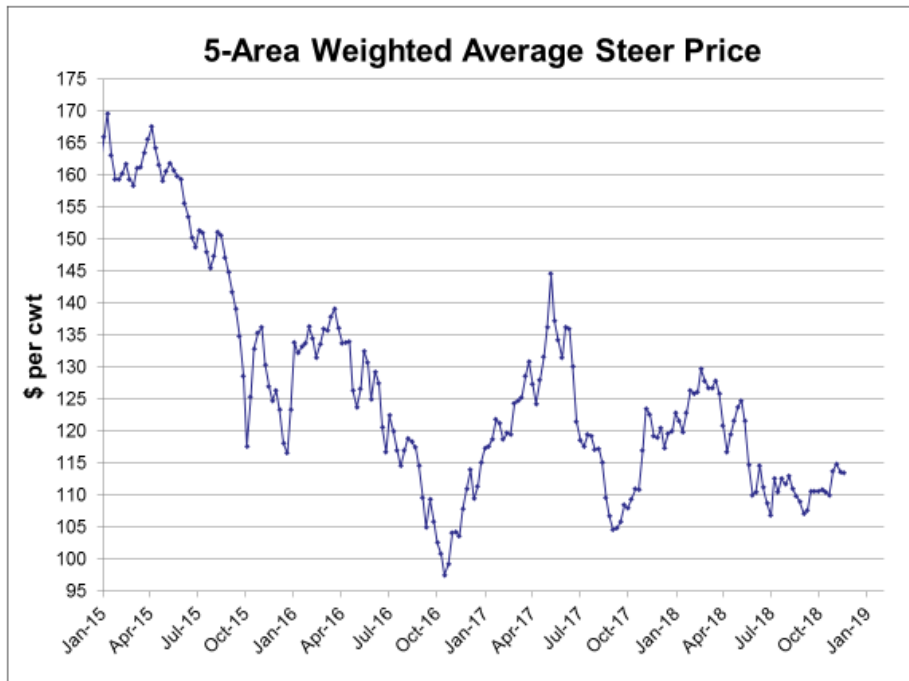


Currently I hold a moderate position in the long December / short June spread. I am risking it down to a close in the December premium below \$.50 per cwt—actually my stop-loss will require two closes

below that level—and the objective is a premium of \$3.50.

This is purely a bet that the astonishingly wide spot packer margin will come back down to Earth, a process that I expect to get underway this week. My Honest-to-God best guess is that beef cutout values will move sideways through mid-December; a decline in the packer margin index from this past week's \$230 per head to \$180 would push the Five Area Weighted Average Steer price up to \$117 with the same cutout value as we have today. [Last year the packer margin index averaged \$77 per head between now and the end of the year.] As I show on the next page, the chart of the cash cattle market would look pretty positive with a print above \$115.

Separately, I am still waiting to sell the June contract outright; my entry target is in the \$114.50-\$115.00 range. This will be my third attempt. I fully expect to be able to sell in that range, for reasons I just described.



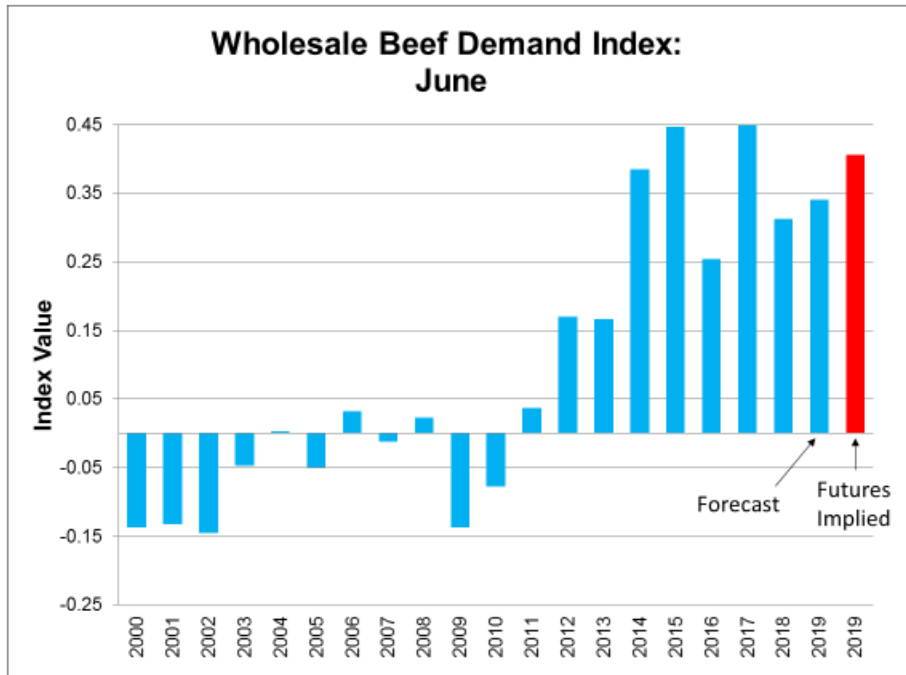
I am aware, of course, that the next major move in the cash market is most likely upward. It looks to me as though the cash cattle market will make its way up to \$125 in the first quarter. However, I notice that

in the past five years, the June contract has maintained a discount to the cash market of \$10-\$17 per cwt in February; \$10.50 to \$17 in March; and \$10-\$18 in April. Thus, my humble forecast of average cash prices around \$121.50 in all three months would reasonably align with a June futures price at or below \$111. And thus, I am willing to bet that the June contract has already established its ultimate high. Further on the subject of basis, the ten-year history suggests that we can expect June futures to average anywhere from \$1.50 to \$4.00 per cwt below the cash market in June. And so, if my forecast of a \$110 cash market in June is in the right ballpark (which, by the way would be virtually the same as a year earlier), then the ultimate value of the June contract should lie somewhere in the \$106-\$108.50 range.

I must say that I am fairly confident of the supply side of the bearish case for June cattle. While it is always possible that placements during November-December-January could, for some reason, be significantly lower than I am anticipating (I'm factoring in a 1% year-over-year decline across the entire period), it seems a "given" that we have not yet seen the cyclical peak in cattle slaughter. Assuming that marketing rates are not extreme in either direction in the meantime, I am coming up with fed cattle slaughter projections that are up 1.7% in the second quarter and, approaching 540,000 per week in June, will challenge the industry's practical slaughter capacity. *My price forecasts also incorporate a 4% increase in U.S. beef exports, which will push net domestic beef supplies slightly below a year earlier in June.*

The bullish case for June cattle is clearly the prospect of surging demand, and the board has already priced in a pretty optimistic scenario—excessively so,

compared with current and recent measurements. In the picture below I show a history of the demand index in June, along with the futures-implied level and my projection—which, by the way, would place the combined Choice/Select cutout value between \$221 and \$222 per cwt, compared with \$217.10 a year earlier.



Forecasts:

	Nov*	Dec*	Jan*	Feb	Mar	Apr
Avg Weekly Cattle Sltr	626,000	598,000	609,000	602,000	615,000	630,000
Year Ago	625,700	593,800	595,400	594,200	600,400	620,100
Avg Weekly Steer & Heifer Sltr	493,000	474,000	477,000	473,000	486,000	500,000
Year Ago	498,600	472,600	466,400	465,800	470,400	491,300
Avg Weekly Cow Sltr	123,000	116,000	124,000	121,000	120,000	119,000
Year Ago	116,700	111,600	120,400	119,500	119,700	118,000
Steer Carcass Weights	896	889	883	876	869	856
Year Ago	902.6	902.8	892.8	884.0	877.0	861.3
Avg Weekly Beef Prodn	514	491	496	489	498	502
Year Ago	519.2	495.3	492.5	488.1	490.0	498.4
Avg Cutout Value	\$211.25	\$210.75	\$216.00	\$215.50	\$221.00	\$221.00
Year Ago	\$205.15	\$199.67	\$206.72	\$212.70	\$222.00	\$212.70
5-Area Steers	\$114.50	\$117.00	\$120.00	\$121.50	\$121.50	\$121.50
Year Ago	\$121.03	\$120.00	\$123.36	\$127.65	\$125.40	\$120.41

**Includes holiday-shortened weeks*

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