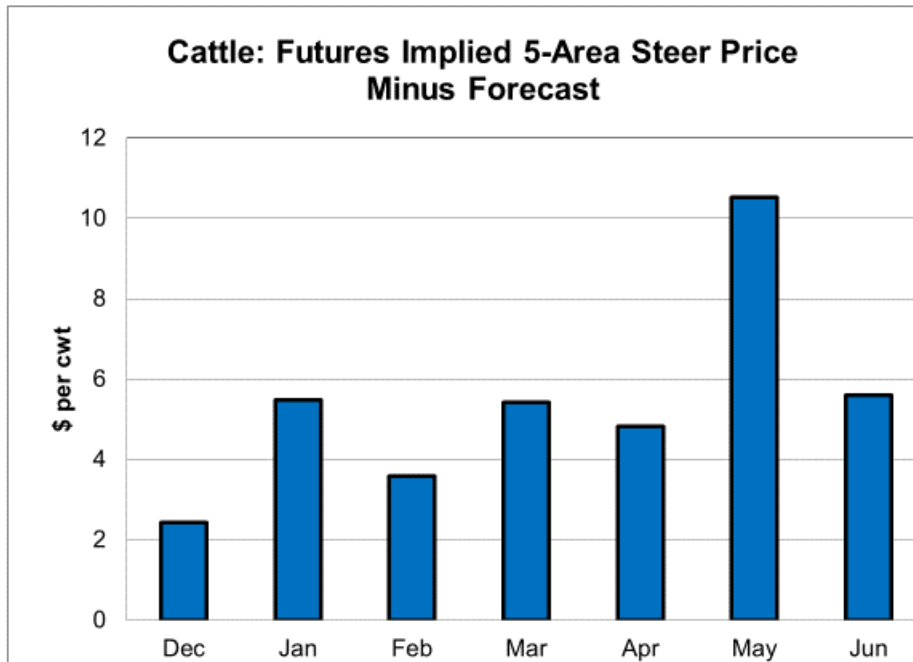


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

December 10, 2018



Over the past month or so I have gradually raised my sights for the prospects of cattle prices in the second quarter, responding to better-than-expected demand readings of late and a

reduction in placements this fall. [They were down 5% from a year earlier in September; down 6% in October; and my guess is that they were off another 6% in November.] Yet, the April and June contracts remain overly optimistic, and both have probably established their contract highs.

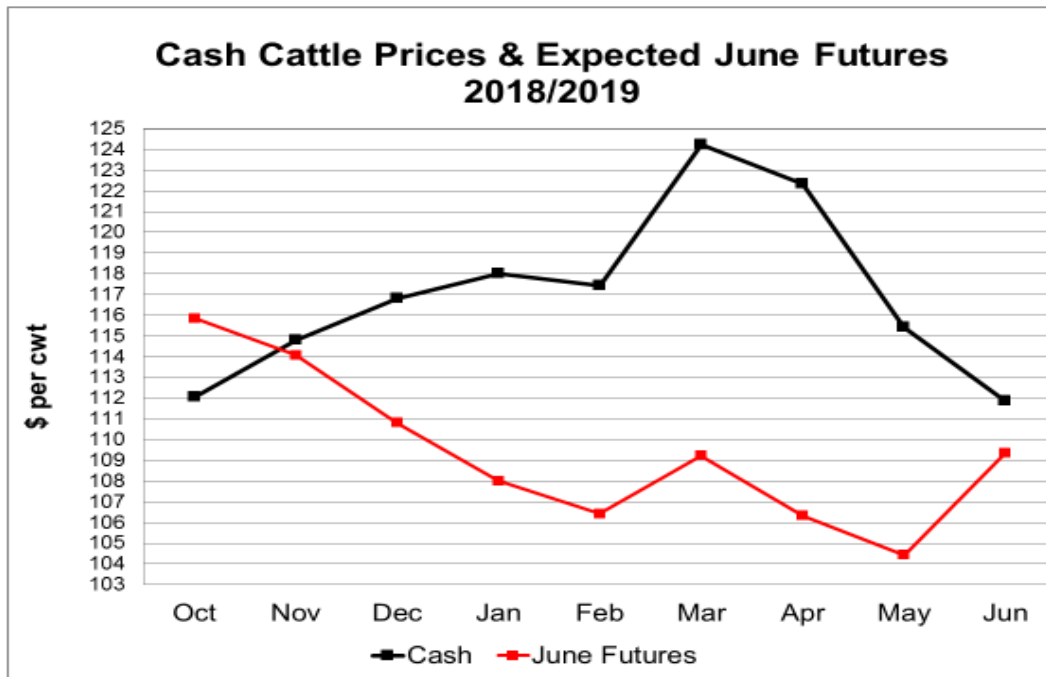
Thus, I remain aggressively short of June cattle, with a close-only stop on one half of that position at \$115.50. This price is not what I would call a “deal-breaking” resistance level; but my intention is to enable myself to sell this market again upon a test of the contract high (\$117.50) without taking on an inordinate amount of risk. I had considered buying the April contract as a defensive measure instead, since this one has already closed above its major downtrend line (twice in the last three sessions), and since, presumably the April contract would lead the way if we are indeed in the midst of another leg up. But rarely have I been able to successfully “spread up” an outright long or short position as a defensive measure, without muddying the picture. And so, I shall retain the simple close-only stop, as is.

The reduction in placements, although it has persisted for three months, is a temporary condition. The rate of growth in feeder cattle supplies has certainly slowed, but it has not yet reached an inflection point. Granted, the likelihood of a flood of “calf-feds” from feedyards in the second quarter has diminished, but it still looks as though front-end supplies will be ample to support steer and heifer kills of 540,000 per week in June, a rate that will challenge practical slaughter capacity and push packer margins out to unseen levels. This is one reason why I prefer to place my bet in the June contract.

On that subject, I am asked why I choose to be short of the June contract here in December, since it will take so long to collect the profit if my assessment of ultimate value is correct. My answer is, who’s to know how long it will take? If the June basis tracks fairly closely with last year’s levels—which it *has*, recently—then June futures will begin their descent sooner rather than later. The futures-minus-cash basis levels I’m talking about are as follows:

Dec	Jan	Feb	Mar	Apr	May	Jun
-\$6/cwt	-\$10	-\$11	-\$15	-\$16	-\$11	-\$2.50

And if the June basis follows this sort of pattern, and *if* my cash market forecasts are in the right ballpark, then this is how things could be expected to unfold:



Of course, the figures for October and November are actual results. I must be out of my mind to show this picture and expose myself to ridicule down the road. But one thing this view does is to demonstrate how far the June contract could descend into “undervalued” territory before it’s all over.

As for demand, this past week's performance was truly impressive. The fed cattle component, at 530,000, was shockingly large and the biggest since June, and the combined Choice/Select cutout value was able to hold basically steady. And yet, the insipid forward booking volumes for later this month and January delivery suggest that the wholesale demand index is at a short-term cyclical peak. With the bulk of the seasonal decline in rib cuts still lying ahead, along with a likely setback in 50% lean trimmings, cutout values should not be able to make any headway for a while.

Meanwhile, the Five Area Weighted Average Steer price has pushed into a formidable resistance zone, after rising for three consecutive weeks and gaining \$5 per cwt in the process....due for a setback, or at least a leveling-out?

Forecasts:

	Dec*	Jan*	Feb	Mar	Apr	May*
Avg Weekly Cattle Sltr	609,000	615,000	608,000	614,000	626,000	651,000
Year Ago	593,800	595,400	594,200	600,400	620,100	642,200
Avg Weekly Steer & Heifer Sltr	484,000	484,000	480,000	486,000	500,000	526,000
Year Ago	472,600	466,400	465,800	470,400	491,300	517,100
Avg Weekly Cow Sltr	115,000	122,000	119,000	117,000	115,000	113,000
Year Ago	111,600	120,400	119,500	119,700	118,000	113,800
Steer Carcass Weights	895	889	882	875	862	852
Year Ago	902.8	892.8	884.0	877.0	861.3	848.4
Avg Weekly Beef Prodn	502	504	497	499	502	518
Year Ago	495.3	492.5	488.1	490.0	498.4	510.2
Avg Cutout Value	\$209.25	\$213.00	\$209.50	\$225.50	\$222.50	\$228.00
Year Ago	\$199.67	\$206.72	\$212.70	\$222.00	\$212.70	\$224.53
5-Area Steers	\$117.00	\$118.00	\$117.50	\$124.00	\$122.50	\$115.50
Year Ago	\$120.00	\$123.36	\$127.65	\$125.40	\$120.41	\$116.36

**Includes holiday-shortened weeks*

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