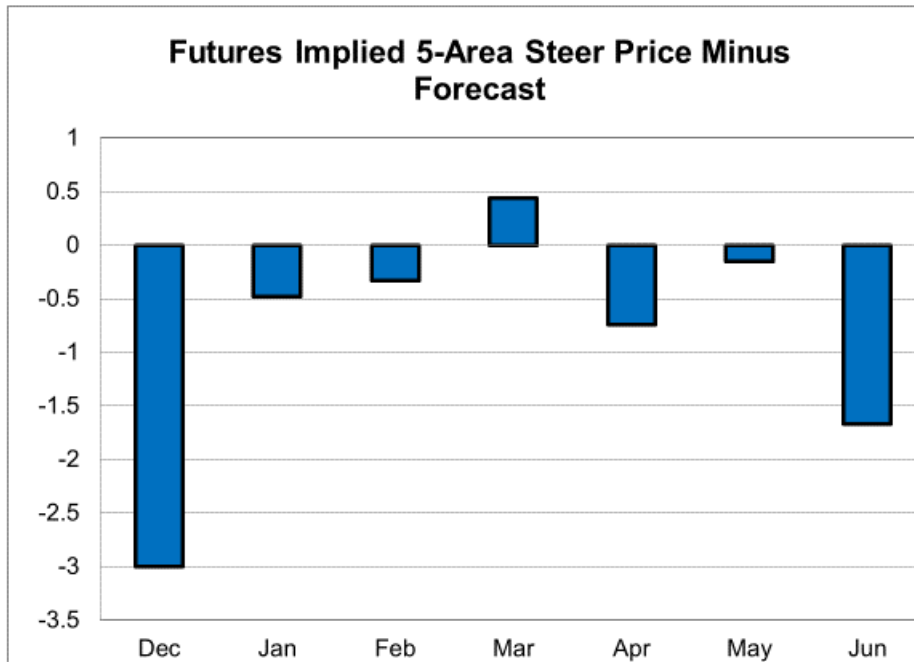


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

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Having exited the long December / short February spread, I now hold only a minimal outright long position in December cattle. Of course, there is probably not much left to be either gained or lost from this position, as I do not intend to carry it into the final week of the

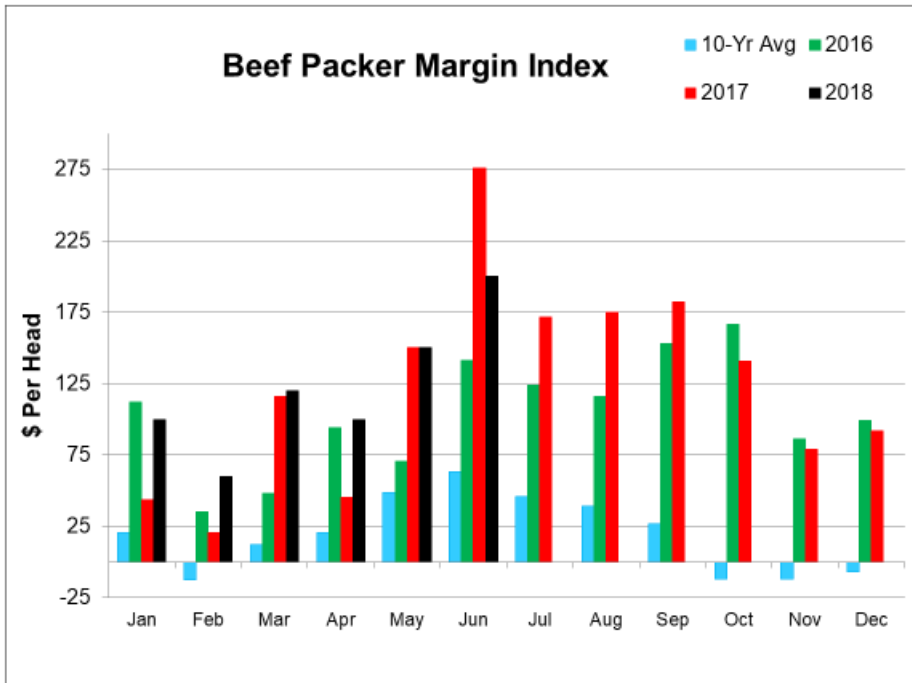
month—which leaves just eight trading days with which to work. But my best guess is that the remaining days of the December contract will carry it up to \$119, attended by a Five Area Weighted Average Steer market of \$118-119 per cwt. That would require nothing out of the ordinary in terms of fed cattle slaughter (495,000-500,000 both this week and next); wholesale beef demand (neither stronger nor weaker than the average change between now and the end of the month); or packer margins (the same as they were last week). And so my revised upside target is \$119.00;. Now that the market has attempted an earnest rally, December cattle should not fall back below \$115.00; if it does, then I'm out.

Otherwise, the picture above gives me little cause for enthusiasm. Starting with my technical wizardry, the near term trend is unmistakably down. The February contract has formed a steep, distinct downward channel, the bottom of which passes through about \$116.75 today and about \$114.85 a week from now. Since long speculators and long index funds currently comprise almost 40% of the total open interest, it is not so difficult to imagine the market testing the bottom of the channel via long liquidation. The equivalent prices in the April contract are approximately \$118.60 (today) and \$117.15 next Wednesday.

Also included on the list of potentially negative considerations is that the prospects for wholesale beef demand in January are not particularly rosy. I make this observation based on the rather tepid forward booking interest for January delivery. My forecasts shown in the table below assuming that there will be a substantial decline in the seasonally adjusted wholesale demand index from November (which was the cyclical peak) to January, and a slight decline from

December to January. These are objective assumption from several different angles, but I would err to the weaker side.

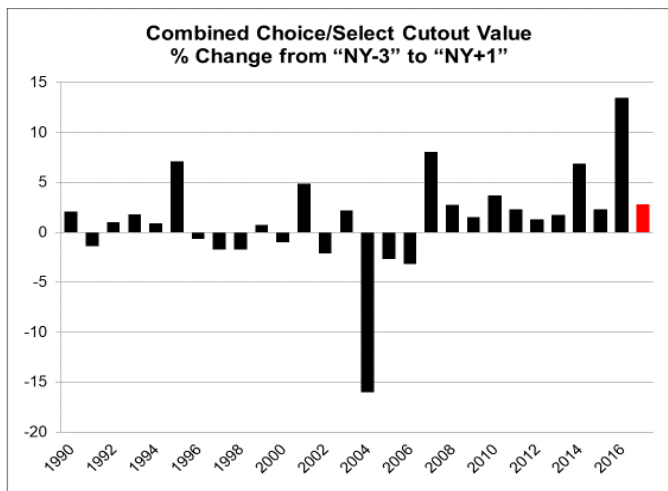
Finally, my forecast of a \$120.50 per cwt cash cattle market in February assumes a significant tightening of packer margins. While this has been a regular seasonal occurrence, I am intuitively leaving open the possibility that margins could be wider than the \$60 per head index value shown in the chart below. A \$75 index value instead of \$60 would lower the cash price forecast to about \$119.25, all else remaining the same:



As for futures-minus-cash basis, current readings are very normal for this time of year. The premium in the February contract is roughly \$2 per cwt vs. the 15-year average of +\$2.44; the February premium stands near \$4 vs. an average of +\$3. On that subject, I notice also

that while February futures have averaged a \$.50 per cwt premium to the cash market during January over the last 15 years, in the last *four* years futures have traded at a discount—by anywhere from \$1.40 to \$6.25 per cwt.

But one basic problem with a short-side bet at this juncture is that the board is *probably* not overvalued near current trade levels....at least, there are good reasons to believe that it is not.



Another is that the next material move in the beef market is most likely upward. Between now and the week after the New Year's holiday—the week ending January 13 in this case—the combined Choice/Select cutout value has appreciated in each of the last eleven years. In the picture at left I include my humble forecast of a 2.5% increase this time around which, as you can see, would be nothing special. A \$2.5% increase would carry the combined cutout back up to its early November peak.

Forecasts:

	Dec*	Jan*	Feb	Mar	Apr	May*
Avg Weekly Cattle Sltr	594,000	605,000	591,000	598,000	610,000	628,000
Year Ago	574,900	576,100	581,400	596,800	599,600	606,400
Avg Weekly Steer & Heifer Sltr	472,000	479,000	469,000	476,000	489,000	507,000
Year Ago	459,300	456,000	458,000	476,500	481,100	490,600
Avg Weekly Cow Sltr	112,000	118,000	113,000	112,000	111,000	110,000
Year Ago	107,200	111,900	114,000	110,200	107,700	104,600
Steer Carcass Weights	897	892	886	878	863	856
Year Ago	903.3	894.0	881.3	871.8	849.0	837.8
Avg Weekly Beef Prodn	491	498	486	489	492	502
Year Ago	479.0	474.8	475.6	485.5	478.6	477.6
Avg Cutout Value	\$198.75	\$202.50	\$197.00	\$211.00	\$209.00	\$212.00
Year Ago	\$189.19	\$192.21	\$190.41	\$213.29	\$208.39	\$232.95
5-Area Steers	\$118.75	\$120.50	\$120.50	\$124.50	\$124.50	\$122.50
Year Ago	\$113.37	\$119.90	\$120.62	\$127.39	\$130.04	\$136.78

**Includes holiday-shortened weeks*

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