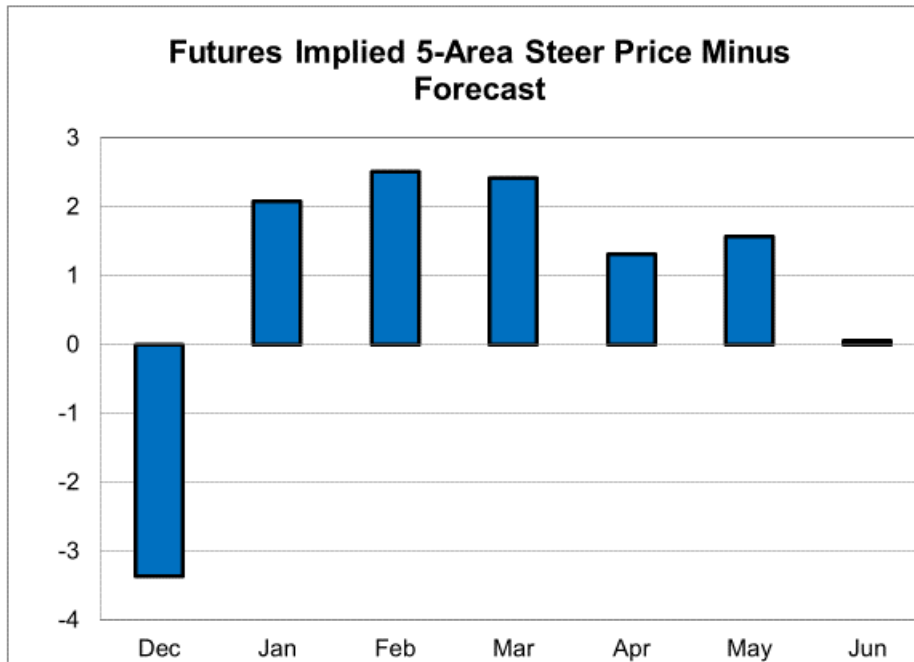


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

December 4, 2017



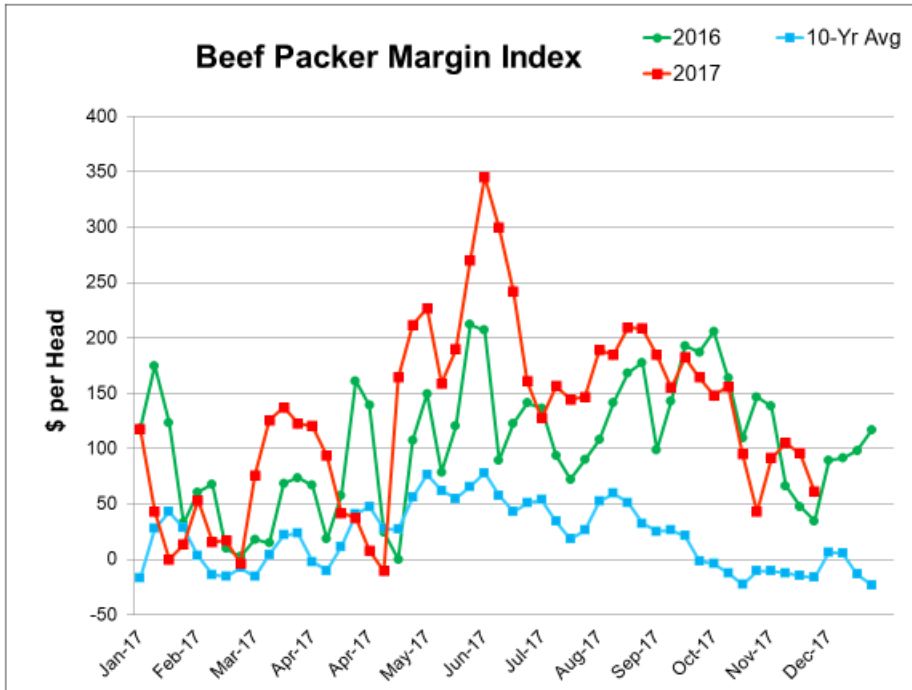
I remain outright long of December cattle, and long of the December / February spread. To get straight to the bottom line, I intend to remove the long-side exposure in the December contract and expand the spread position.

I am reading Friday's close below

\$118.37 in December cattle as a signal that my expectations of the cash market over the next three weeks were overly ambitious. Another not-so-subtle “yellow flag” was that I was caught off-guard by a nearly \$5 per cwt drop in the combined Choice/Select cutout value.

However, the December contract now sits on a major support level (\$117). Another lies about 100 points below, at the 100-day moving average of \$115.80. Can we really expect this one to make another major leg down from here? It seems pretty unlikely. It is clear that heavy rate of production—extraordinarily heavy for this time of year—was largely responsible for the decline in cutout values. I have adjusted my slaughter projections upward through the balance of the year to include a continuation of very aggressive marketing rates, but still it is probable that steer and heifer kills will retreat from 515,000 this past week to an average of about 500,000 between now and Christmas. This, in conjunction with a normal demand pattern through the holidays, would push the combined cutout upward from here, if only back up to \$200 per cwt by the week prior to Christmas. [By the way, carcass weights and marketing rates are unequivocally indicative of a “current” front-end cattle supply.]

In that case, it would require a doubling of the spot packer margin index between now and then in order to place the Five Area Weighted Average Steer price at \$117, which the board is currently discounting. In the picture on the next page, that index value would be \$125 per head; it averaged \$61 this past week. It is not an outrageous possibility....but once again, the futures market has already discounted it.



Thus, I have lowered my sights for the “ultimate value” of the December contract; I am now anticipating a mere return to last week’s high of \$120.77.

The February contract is a different story. This option contains a much bigger chunk of the total open

interest, and is much more vulnerable to long liquidation. Keeping this in mind, last week’s price action was considerably more ominous. Following Friday’s close, there now seems to be an unimpeded path to \$119-\$120, which is just slightly lower than my assessment of “fair value” in the February contract (assuming that weather conditions do not surprise us). If one exercises a bit of imagination, a duplication of the first leg down from the contract highs would measure to \$117.47.

These conditions present some auspicious prospects for the December/February spread, especially since the spread has broken out to the upside—December gaining against February—rather emphatically pushing through all near term hurdles and leaving little in the way of resistance between Friday’s close of \$4.75 (premium to the February) and \$2.80. Considering that the fundamentals also suggest that a narrowing of the gap would be in order, my objective in the spread is in the neighborhood of \$3.00. This would not be unfamiliar territory, since the 15-year average premium in the February contract in the third week of December (on a weekly average closing basis) is \$1.99....

Forecasts:

	Dec*	Jan*	Feb	Mar	Apr	May*
Avg Weekly Cattle Sltr	596,000	606,000	591,000	598,000	611,000	629,000
Year Ago	574,900	576,100	581,400	596,800	599,600	606,400
Avg Weekly Steer & Heifer Sltr	474,000	479,000	470,000	476,000	489,000	508,000
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	895	891	885	877	862	855
Year Ago	903.3	894.0	881.3	871.8	849.0	837.8
Avg Weekly Beef Prodn	491	497	485	488	491	501
Year Ago	479.0	474.8	475.6	485.5	478.6	477.6
Avg Cutout Value	\$199.00	\$203.00	\$197.50	\$211.50	\$209.00	\$212.00
Year Ago	\$189.19	\$192.21	\$190.41	\$213.29	\$208.39	\$232.95
5-Area Steers	\$120.00	\$121.00	\$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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