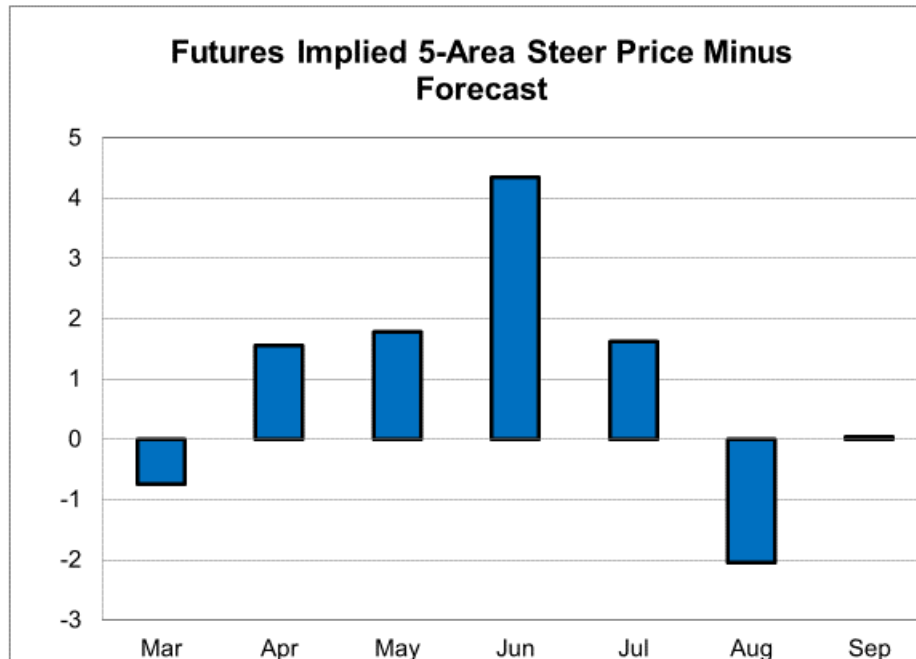


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

February 28, 2018

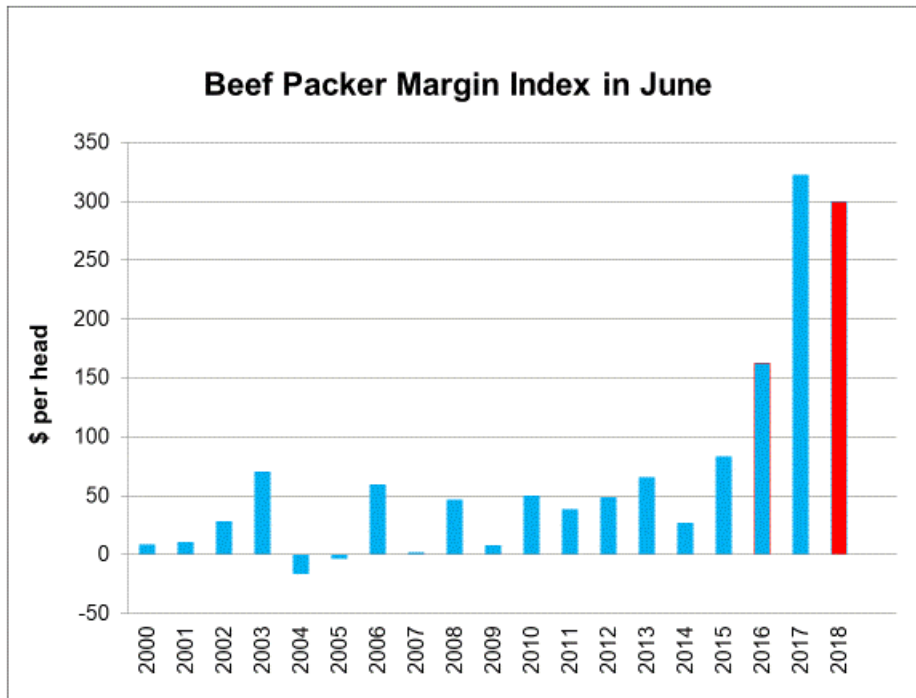


The June contract appears to be sufficiently overvalued enough to justify a short position, but the technical picture does not tell me to sell at this time. As defensive as the price action has been over the past five days, no major damage has yet been

done to the chart. In the June contract, \$116.00 is an obviously important price, having been a point of either major support or major resistance on four separate occasions since last October; so far, closes have held above that level. Also, there is a minor uptrend line originating on January 25, which today lies very near the 40-day moving average, and which likewise has not been penetrated. Finally, I notice that in the April contract the 40-day moving average is crossing above the 100-day MA, and the ten-day MA stands above the 40-day MA; according to the textbook, this means that the trend is upward, does it not? It could be that on this 300-point pullback, the market has simply “reloaded” for another rally. At least, it is enough of a possibility that I can afford to be patient.

As best I can tell, the June contract will ultimately wind up at \$112. The key assumptions underlying this valuation are that domestic wholesale beef demand will undergo a normal seasonal change between February and June; and that packer margins will be very wide by historical standards, but not quite as wide as they were a year earlier (a spot margin index of +\$300 per head vs. +\$323 in June 2017). I’ll show you this picture on the next page. That would place the average cash cattle price at \$114. With an average futures-to-cash discount of \$2 per cwt in June (a middle-of-the-road projection), I arrive at futures price of \$112.

The boldest of the assumptions I just described is the packer margin. If the spot market index were to be +\$250 per head instead of +\$300, then we would be looking at a cash cattle market of \$117.50 and a futures price of \$115.50.



In case you're wondering, this margin index has been above a year earlier in eight of the past twelve months, the exceptions being last April and October through December. February is shaping up to be roughly \$50 per head wider than a year ago.

The near-term "news" from the cash market should be positive, which is another reason why I am being patient about placing a short-side bet. My best guess is that the combined Choice/Select cutout value will gain another \$4 per cwt or so, before topping out in the week after next. But if the market were to match its average performance between now and mid-March, then the rally would extend another \$10 beyond my target. The forward booking statistics indicate that this is unlikely, but sometimes I wonder if I am reading too much into these statistics.

Meanwhile the chart of the Five Area Weighted Average Steer price still exhibits an uptrend, and I do not see any major resistance below \$135 per cwt. A weighted average cash trade above \$130 would signal a move up to \$135. I must say, though, that all things considered, the June contract will probably not make another leg up unless the cash cattle market does push above \$130. The discount in the June contract, at roughly \$10 as of this morning, is actually somewhat narrow compared with the last four years.... in which the discounts in the fourth week of February were \$17 (2014); \$17 (2015); \$11 (2016) and \$18 (2017). I interpret this to mean that it's going to be difficult for the June contract to sustain rallies unless accompanied by an equal or greater increase in the cash market.

Forecasts:

	Mar	Apr	May*	Jun	Jul*	Aug
Avg Weekly Cattle Sltr	607,000	615,000	644,000	662,000	623,000	636,000
Year Ago	596,800	599,600	606,400	637,900	603,800	633,800
Avg Weekly Steer & Heifer Sltr	477,000	486,000	517,000	533,000	497,000	504,000
Year Ago	476,500	481,100	490,600	514,200	488,800	511,000
Avg Weekly Cow Sltr	120,000	118,000	117,000	117,000	115,000	120,000
Year Ago	110,200	107,700	104,600	111,000	104,400	111,000
Steer Carcass Weights	878	863	856	869	883	895
Year Ago	871.8	849.0	837.8	854.0	868.5	884.6
Avg Weekly Beef Prodn	497	496	516	537	510	525
Year Ago	485.5	478.6	477.6	509.6	487.6	517.9
Avg Cutout Value	\$219.00	\$214.50	\$219.00	\$217.00	\$206.50	\$208.00
Year Ago	\$215.06	\$211.23	\$238.12	\$238.48	\$209.64	\$196.81
5-Area Steers	\$129.00	\$125.00	\$122.50	\$114.00	\$115.00	\$117.50
Year Ago	\$127.40	\$130.04	\$136.78	\$126.59	\$118.41	\$110.72

**Includes holiday-shortened weeks*

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