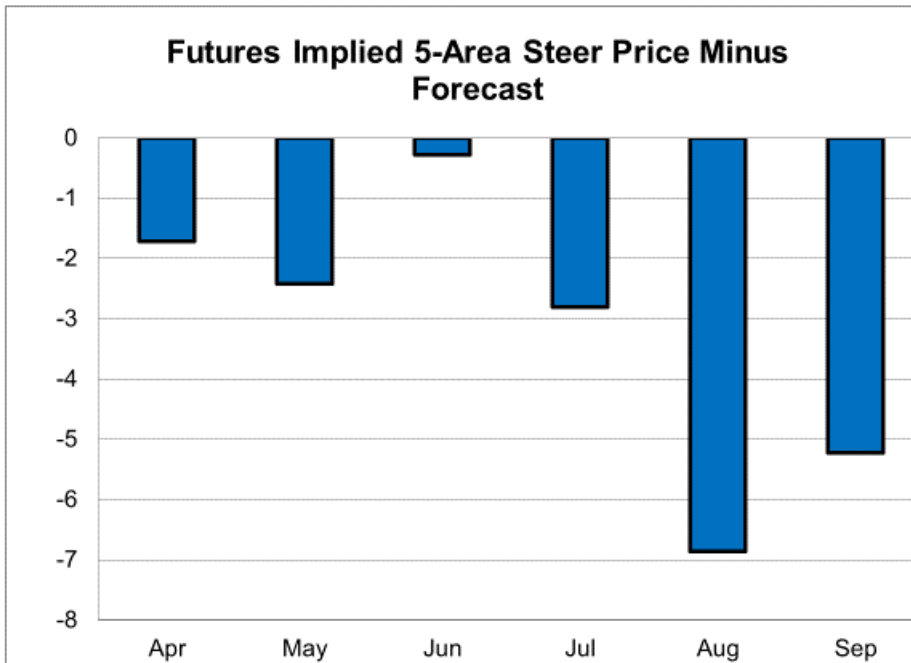


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

March 16, 2018



I have been trying to establish a short position in June cattle (like the rest of the world, it seems), but have been aiming a bit too high. That sort of fault, I can live with. It's infinitely better than being too anxious and betting my money to avoid boredom. When it comes to commodity, I don't have a problem with boredom.

With beef cutout values likely at a major peak—possibly the high for the rest of the year—it is difficult to consider anything other than a play from the short side. After all, we don't yet have solid clues of how far the presumed decline in beef prices will carry. And given the potential cattle supplies, there is a risk that packer margins will widen to levels that are heretofore unseen. But in order to justify a sale, the profit and risk prospects must be sufficiently skewed.... and of course, unless the technical signals are extraordinarily compelling, the board must be sufficiently overvalued.

Applying the most objective assumptions I can muster, the June contract is not significantly overpriced at all. To recount: these assumptions include beef production at 536 million pounds per week in June vs. 510 million a year earlier; a demand pattern that follows along a seasonally normal path between now and then, compared with an unusually great increase between March and June last year; a combined Choice/Select cutout value averaging \$217.50 per cwt vs. \$238.48 a year earlier; a spot packer margin index of +\$300 per head vs. +\$323 a year earlier (which was an all-time record for any single month, by far); and a Five Area Weighted Average Steer price of \$113.50 vs. \$126.59 a year earlier.

In fact, the best trading opportunities at the moment appear to be on the long side of the August or October contracts. Once again, though, it would be challenging and stressful to try to pick a bottom just ahead of a major slide in cash cattle prices. I think I would have to see an August futures price around \$104 before I could put myself in that position. A close below \$107.50 in

August cattle does not seem too far away, in view of the bearish news that lies ahead; and if that happens, there is nothing on the chart that would stand in the way of a move down to \$103.50.

The only viable alternative, then, is the short June/long August or short June/long October spread. This is already a rather well-known secret.... but there still may be a considerable amount of profit potential remaining. It is not often that the preliminary supply side indications so clearly point to a shift in favor of the back end of the market vs. the front end. I am referring to the probability of a significant reduction in springtime placements, a notion that stems from the fact that a large number of cattle were moved off of wheat pasture early this year due to drought conditions—which reflects the fact that the supply of feeder cattle outside feedlots was down 2% from a year earlier on January 1, while January/February placements were up 5%. In five of the past ten years, the June/October spread has moved out to a June discount of \$5 or more, and the supply-side fundamentals suggest that such a discount is quite possible this time around. It closed today near even money. The “basing”-type of price action over the past ten trading days makes me hopeful that I will have a chance to enter this spread near \$1.00 premium to the June contract, which is about where the major downtrend line passes through today.

Forecasts:

	Mar	Apr	May*	Jun	Jul*	Aug
Avg Weekly Cattle Sltr	613,000	614,000	644,000	659,000	619,000	629,000
Year Ago	596,800	599,600	606,400	637,900	603,800	633,800
Avg Weekly Steer & Heifer Sltr	474,000	487,000	518,000	531,000	494,000	498,000
Year Ago	476,500	481,100	490,600	514,200	488,800	511,000
Avg Weekly Cow Sltr	119,000	117,000	116,000	116,000	114,000	119,000
Year Ago	110,200	107,700	104,600	111,000	104,400	111,000
Steer Carcass Weights	879	868	857	870	885	897
Year Ago	871.8	849.0	837.8	854.0	868.5	884.6
Avg Weekly Beef Prodn	493	496	517	536	507	520
Year Ago	485.5	478.6	477.6	509.6	487.6	517.9
Avg Cutout Value	\$221.00	\$215.00	\$218.50	\$217.50	\$207.50	\$209.00
Year Ago	\$215.06	\$211.23	\$238.12	\$238.48	\$209.64	\$196.81
5-Area Steers	\$128.00	\$125.00	\$122.00	\$113.50	\$114.50	\$118.00
Year Ago	\$127.40	\$130.04	\$136.78	\$126.59	\$118.41	\$110.72

*Includes holiday-shortened weeks

Trading Cattle is published weekly by Procurement Strategies Inc., 99 Gromer Road, Elgin IL 60120. For subscription information, please contact Kevin Bost at (847) 212-7523; or visit our website at www.procurementstrategiesinc.com.

Information herein is derived from sources believed to be reliable, with no guarantee to its accuracy or completeness. There is a substantial risk of loss in trading futures and options especially when not hedged against a cash position. Opinions expressed are subject to change without notice. Each investor must consider whether this is a suitable investment. All funds committed should be risk capital. Past performance is not necessarily indicative of future results.

