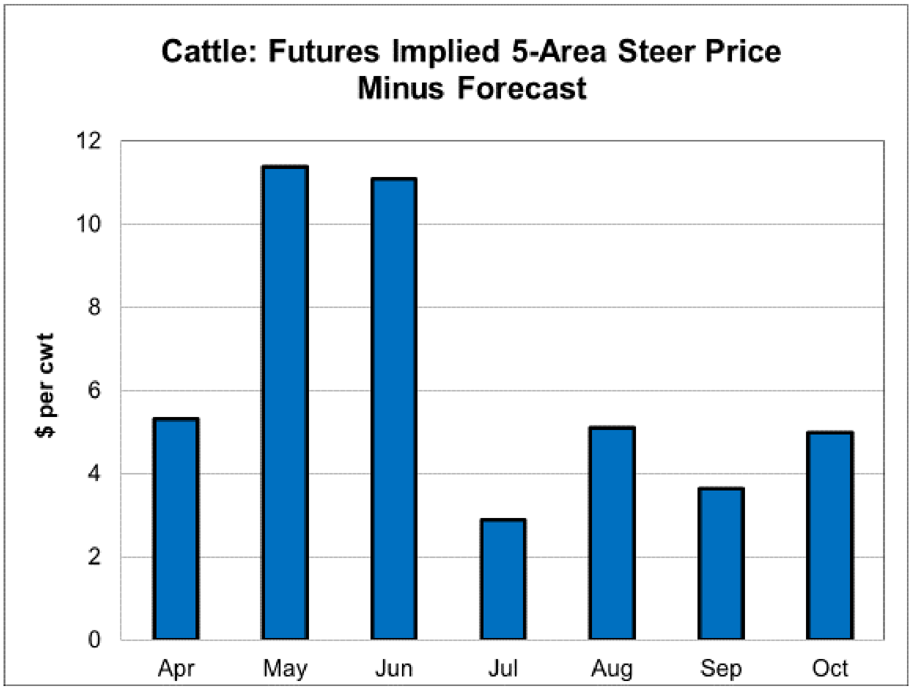
Trading Cattle
…. from a meat market perspective
A commentary by Kevin Bost

March 19, 2019



I am aggressively short of April cattle with a close-only stop at the contract high of $130.45 per cwt. Last Tuesday's emphatic move below $128.00 should have confirmed a top in this market, and I still believe that it did--although I say this with considerably less conviction than I would have just two trading days ago. Friday's close back above the ten-day moving average (and the simultaneous close into new highs in the June contract) took me by surprise. I had thought that last week's penetration of both a major trend line and the 40-day moving average would have triggered more long liquidation than it did. But those same technical developments did not occur in the June contract, in which open interest is more than twice as large as in the April contract; and this is a logical explanation for the lack of follow-through after the break.

The fundamental case for another leg downward in April futures seems pretty solid, and the basic premise is simple: the beef market appears to have peaked (until May, that is), and packer margins are unlikely to narrow materially at this time of year; therefore, declining cutout values should pull cash cattle prices down with them.

Clearly, the most bullish argument for higher cash cattle prices at this stage of the game is that cattle will not move out of feedlots in the Central Plains and

Midwest because of flooding and mud. This argument, I can appreciate. But how big is this “blockade” in the grand scheme of things, and how long will it persist? Probably not all the way through April, I am guessing. Also, I notice that fed cattle slaughter averaged 4,500 head per week above a year earlier in January, and 3,800 head above a year earlier in February….and feedlot conditions and performance were not too swell at that time either, as I recall. The inventory of cattle on feed 120 days or longer project to be up 7% from a year ago on April 1, which should readily support steer and heifer kills at an average rate of 494,000 per week in April….and which would be 2,500 head above a year ago. Anything below that rate would be the result of a sluggish marketing pace.

But at this rate of production, a slightly stronger-than-seasonally-normal pattern in wholesale beef demand would result in a pullback in the combined Choice/Select cutout value lasting three to four weeks and amounting to roughly \$8 per cwt. The equivalent pullback at this time last year was twice as steep, but in light of much-improved forward sales volumes of late, I expect this one to be considerably milder. If spot packer margins remain right where they are now, then the Five Area Weighted Average Steer price will slip to \$122-\$123 per cwt in the process.

The keys to the behavior of cutout values in the near term will be the knuckles, bottom round flats, shoulder clods, ground beef, and Select-grade loin cuts, all of which are poised for a sharp seasonal setback.

And in regard to the notion of a steady packer margin, one consideration is that forward-contracted cattle for April delivery number about 15,000 per week above a year ago, while slaughter looks like it will be up only marginally.

The high likelihood of a setback in cash cattle prices right in front of us is but one reason why my short position is held in the April contract and not in the June, where the profit potential appears to be much greater. The main reason, though, is that the June contract, as of this morning, is giving no indication whatsoever that its uptrend is finished. And so I will have to see a convincing technical signal, telling me that the top is “in” before I can move my short position from April to June. At this juncture, with the peak in the cash market probably having been established, I would be willing to jump on board of an outside range/reversal, whenever that might occur. Until that happens, though, the nearest support level below which a round of heavy long liquidation would be triggered is the 40-day moving average. Today, this passes through \$120.65.

Forecasts:

	Mar	Apr	May*	Jun	Jul*	Aug
Avg Weekly Cattle Sltr	607,000	625,000	647,000	656,000	626,000	646,000
Year Ago	600,400	620,100	642,200	654,000	623,900	643,400
Avg Weekly Steer & Heifer Sltr	473,000	494,000	519,000	527,000	499,000	514,000
Year Ago	470,400	491,300	517,100	526,100	499,100	512,600
Avg Weekly Cow Sltr	124,000	121,000	117,000	117,000	116,000	121,000
Year Ago	119,700	118,000	113,800	116,200	114,000	119,600
Steer Carcass Weights	871	861	852	863	877	892
Year Ago	877.0	861.3	848.4	857.5	870.0	884.8
Avg Weekly Beef Prodn	490	500	515	527	507	530
Year Ago	490.0	498.4	510.2	523.2	503.3	525.3
Avg Cutout Value	$224.50	$221.00	$228.50	$223.00	$213.50	$214.00
Year Ago	$222.00	$212.70	$224.53	$217.10	$204.61	$207.50
5-Area Steers	$126.00	$123.50	$118.00	$113.50	$117.00	$114.00
Year Ago	$125.40	$120.41	$116.36	$110.39	$111.87	$110.02

**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.