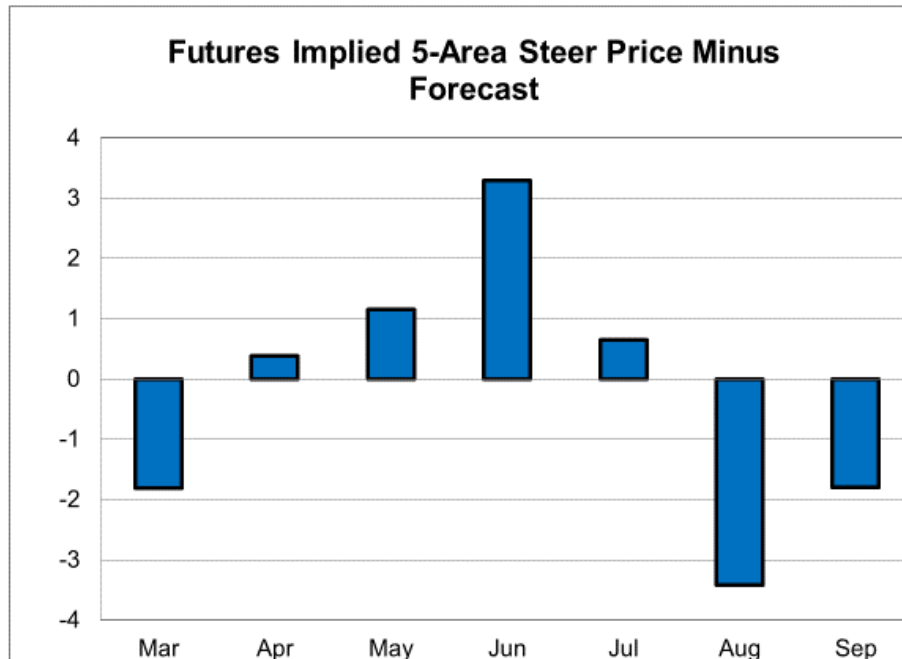


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

March 7, 2018



I have no money on the table at the moment, and the picture at left gives me little inspiration—except to explore a little more seriously one of the bear spreads including a short leg in the June contract. I'm a little late coming to this party, but there appears to be considerable potential remaining.

The ultimate success of a short June / long August or short June / long October spread will largely depend on the amount of weakness that besets the June contract. Because the beef market is probably reaching a peak right now, I am convinced that June cattle will not again trade above \$119.00.... and quite likely, not above \$117.60. As I consider an outright short position, though, I respect the fact that the market currently is in a sideways mode, bounded roughly by \$114 on the low side and \$119 on the high side. The approximate midpoint of that range is \$116.50, and so I should place my entry point somewhere above that level—that is, until the support at \$114.00 breaks down. My stop loss, of course, would be placed at \$119.00 on a close-only basis.

I have to constantly revisit my assumptions underlying the notion that June cattle are ultimately worth only \$113-something, and that they will, at some point, trade down to \$111. Among the Smart People it is widely accepted that supplies will be big during the May-June-July period. My personal guess is that net domestic beef supplies in June will be about 3.5% larger than a year earlier, and that the increase in this metric from February to June will be sharper than usual (11.0% vs. the ten-year average of 7.6%).

Less certain are the assumptions regarding wholesale beef demand and packer margins. My forecast projects that the wholesale demand index will be about the same in June as it was in February—meaning that demand will simply undergo normal seasonal changes between now and then. I'm OK with that. I see nothing on the horizon that would cause any material deviation from

that path. Therefore, a combined Choice/Select cutout value averaging \$217 per cwt seems objective and realistic. As for the packer margin index, my guess is that it will be +\$300 per head. I'm just taking a stab. This is a wide margin, no doubt; but it is actually narrower than the June 2017 average of +\$323.... but then, the beef market is unlikely to be as strong this time around. Considering that steer and heifer kills will be pressing closely against practical slaughter capacity at that time, I regard +\$250 as a conservative possibility—a more bullish possibility, I mean. In that case, a \$217 combined cutout would align with a cash cattle market of \$117.50. I have to respect this possibility as well.

As far as the beard spread is concerned, the August/June spread has plenty of fundamental merit, but I slightly prefer the October contract as a long leg because of the presumed trend toward lighter placements as we move through the spring. If I really had any guts, I would probably reach out into the December contract. This morning the June / October spread trades at about even money, which compares with a June premium of nearly \$5 per cwt in the first week of March in each of the last two years, but the 15-year average for this point on the calendar is a June discount of \$2.01. In the middle of May, the average is a June discount of about \$3.50, and six times in the last 15 years the discount has been \$5.00 or more. In my humble estimation, the June contract is worth about \$5 less than the October contract. I will try to enter this spread if it trades back up to its major trend line, which today passes through \$1.35 (premium to the June contract).

Forecasts:

	Mar	Apr	May*	Jun	Jul*	Aug
Avg Weekly Cattle Sltr	613,000	614,000	644,000	659,000	618,000	629,000
Year Ago	596,800	599,600	606,400	637,900	603,800	633,800
Avg Weekly Steer & Heifer Sltr	477,000	487,000	517,000	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	878	866	859	872	887	899
Year Ago	871.8	849.0	837.8	854.0	868.5	884.6
Avg Weekly Beef Prodn	495	497	518	536	508	520
Year Ago	485.5	478.6	477.6	509.6	487.6	517.9
Avg Cutout Value	\$221.00	\$215.00	\$218.50	\$217.00	\$207.00	\$209.00
Year Ago	\$215.06	\$211.23	\$238.12	\$238.48	\$209.64	\$196.81
5-Area Steers	\$129.00	\$125.00	\$122.00	\$114.00	\$114.50	\$119.00
Year Ago	\$127.40	\$130.04	\$136.78	\$126.59	\$118.41	\$110.72

*Includes holiday-shortened weeks

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