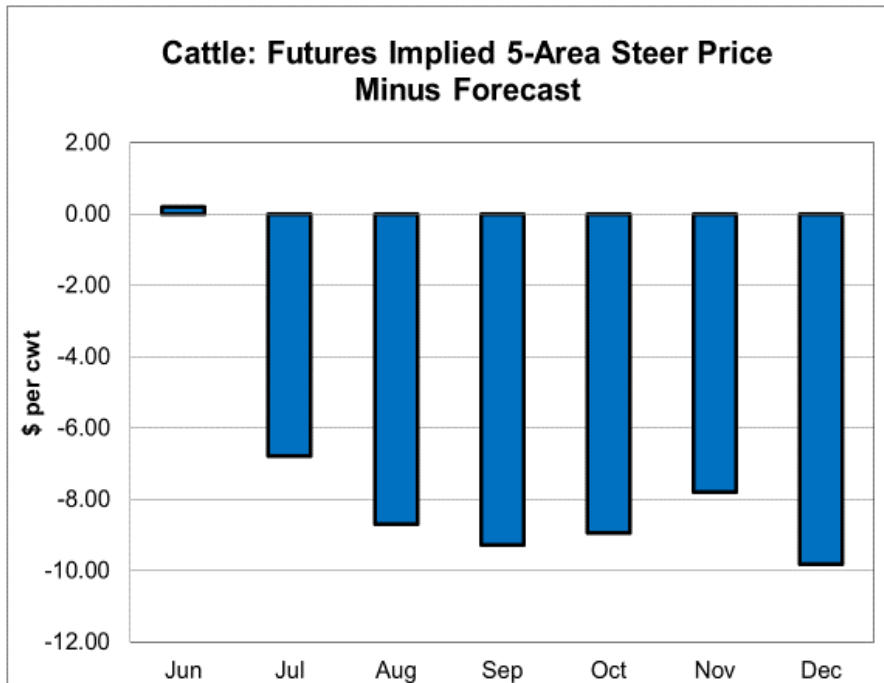


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

May 15, 2019

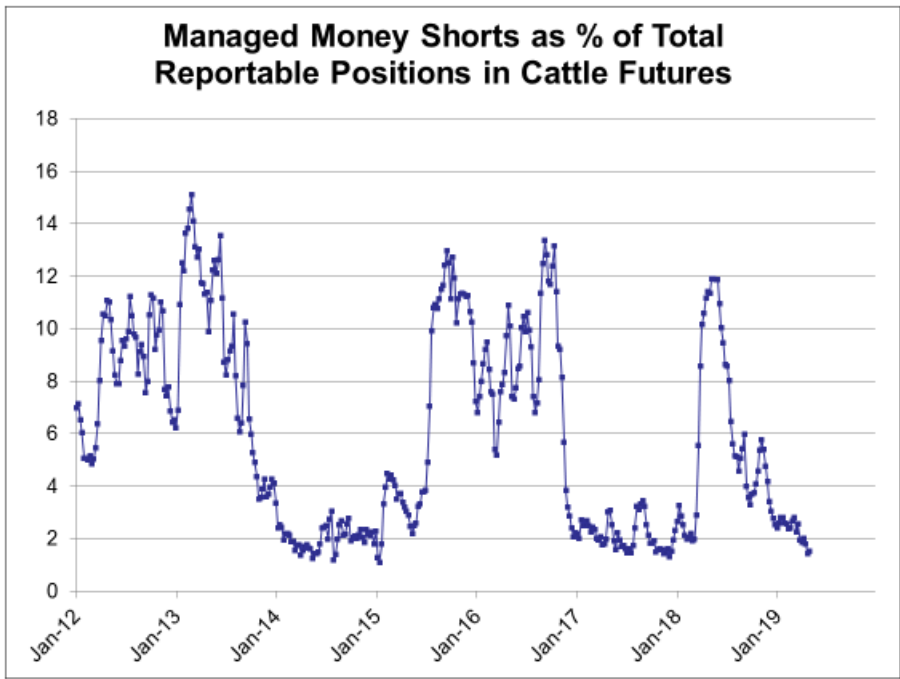


The August, October, and December contracts appear to be sufficiently undervalued to warrant a long position of some sort, but I'm not putting any money on the table just yet. Obviously, the chart and the price action give no indication that

a bottom is at hand. And even though the long position among managed money traders has been pared back quite a bit, as of the most recent reading it was still in "moderate" territory. There is room for more long liquidation, and who's to say that the funds will not convert to the short side? Currently, their short positions comprise a miniscule 1.4% of the total reportable position; at about this time last year, it stood at 12%. This picture is shown on the next page.

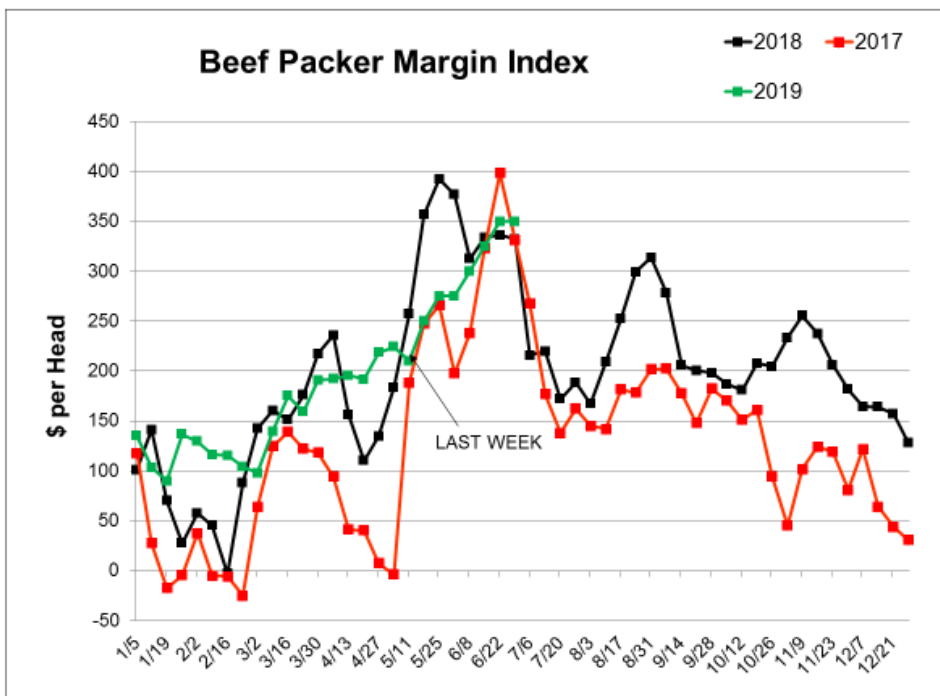
Apart from the technical factors, there are two considerations that warn me not to be anxious about buying anything. One is that packer margins could swell beyond the degree that I am factoring into my forecast; the other is that I simply don't know how much of a discount the August futures contract will choose to carry.

So far, packer margins have widened only gradually; in fact, they have momentarily dropped below year-earlier levels. This, I'm sure, is due to the fact that beef cutout values are sliding here in May, instead of rallying as they were last year. But that situation could change a *lot* between now and the end of June.



No one seems to be talking about slaughter capacity, but it could become more of a factor in June. My perception is that *practical, sustainable* capacity is not far above last week's kill of 536,000

steers and heifers. If they are operating near capacity, packers' appetite for cattle could be constrained. It may also be constrained by the fact that the number of cattle contracted for June delivery is about 32,000 head greater than it was at this time last year. In July, that differential swells to 58,000.



It's possible, then, that spot packer margins could exceed \$400 per head; after all, they reached that level, albeit briefly, in each of the last two years.

My forecast of a \$111-\$112 per cwt average cash market in June assumes an average packer margin index of \$330 per head, the same as a year ago; but at \$400, a combined cutout value near \$220 per cwt would place the Five Area Weighted Average Steer price at \$106.

On the subject of basis, I notice that during the month of June, the August futures contract averaged \$6.00 to \$8.50 per cwt below the cash market in each of the last three years. So, then, if the cash cattle market is to average \$111-\$112, then can I honestly expect closes in the August contract to average any higher in June than they are right now?

The main reason why my cash price forecast in August is so high relative to the board is that the beef market is heading into a “demand building” mode through more aggressive forward pricing (which has been lacking for a couple of months now). Accordingly, the volume of product being booked for delivery one to two months into the future has increased noticeably, and now stands significantly above a year ago. It will take some time for this to manifest into stronger demand at the wholesale level, but I expect this influence to show up in late June and early July. The seasonally adjusted demand index appears to be headed for a short-term cyclical low either here in May or in the first half of June.

I will be open to the idea of buying into a sharp drop in August cattle, in modest quantity, perhaps somewhere in the neighborhood of \$104.00. At this time, I don't know exactly what price that will be; but until the market demonstrates that it is tired of going down, I will be aiming low. In the meantime, I am holding a long August/short June spread, expecting--hoping--that this spread will eventually trade at par or even an August premium.

Forecasts:

	May*	Jun	Jul*	Aug	Sep*	Oct
Avg Weekly Cattle Sltr	653,000	661,000	626,000	643,000	634,000	644,000
Year Ago	642,200	654,000	623,900	643,400	632,200	641,500
Avg Weekly Steer & Heifer Sltr	522,000	532,000	500,000	513,000	506,000	510,000
Year Ago	517,100	526,100	499,100	512,600	504,500	505,500
Avg Weekly Cow Sltr	120,000	117,000	115,000	118,000	117,000	123,000
Year Ago	113,800	116,200	114,000	119,600	117,100	125,000
Steer Carcass Weights	854	866	880	894	906	911
Year Ago	848.4	857.5	870.0	884.8	897.0	898.0
Avg Weekly Beef Prodn	520	532	510	529	528	539
Year Ago	510.2	523.2	503.3	525.3	522.0	528.0
Avg Cutout Value	\$221.50	\$220.50	\$216.00	\$218.00	\$211.50	\$210.00
Year Ago	\$224.53	\$217.10	\$204.61	\$207.50	\$204.18	\$205.70
5-Area Steers	\$118.25	\$111.50	\$114.50	\$116.00	\$114.00	\$114.50
Year Ago	\$116.36	\$110.39	\$111.87	\$110.02	\$109.89	\$112.06

*Includes holiday-shortened weeks

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