

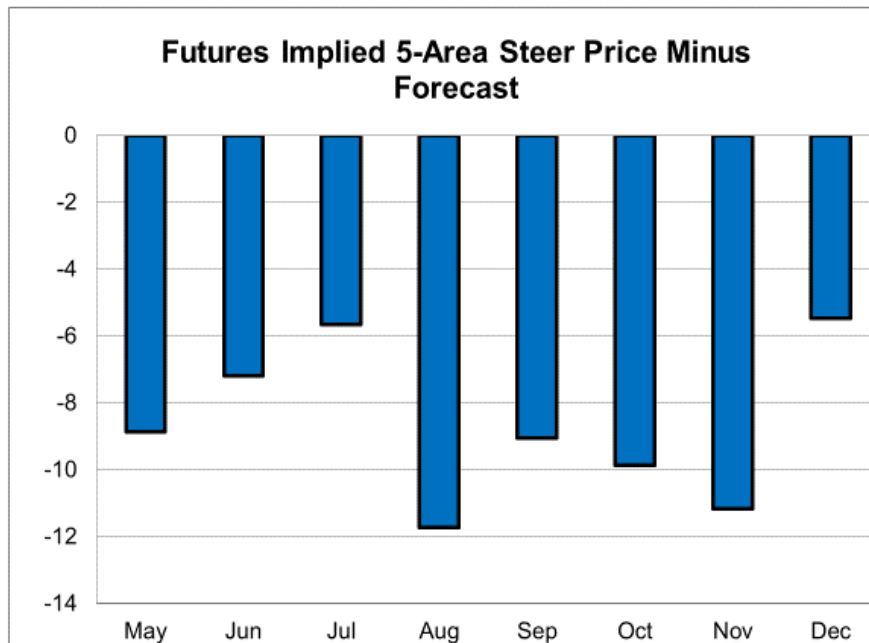
# Trading Cattle

## .... from a meat market perspective

A commentary by Kevin Bost

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May 2, 2018



I am waiting as patiently as I can to place a bet on the long side of August cattle. My wish remains to buy them near \$102.00, against which I would use a close-only stop below \$101.70. That price I view as a major support level that will not be penetrated (on

a closing basis) if the August contract is worth as much as I think it is.

So, then, if the upside objective is 1300 points above today's close and the downside risk measures 250 points from here, why should I not just go ahead and buy it? It's a good question, especially as I consider that the June contract has been making higher highs and higher lows since it hit bottom on April 4. The month-long trend in the August contract has been more sideways, but similar. And the market's inability to follow through on its attempted breaks within the past week or so is indicative of the heavy short position among large speculators. The beef market, meanwhile, looks pretty solid, and it has performed better than I had anticipated in the past weeks and a half.

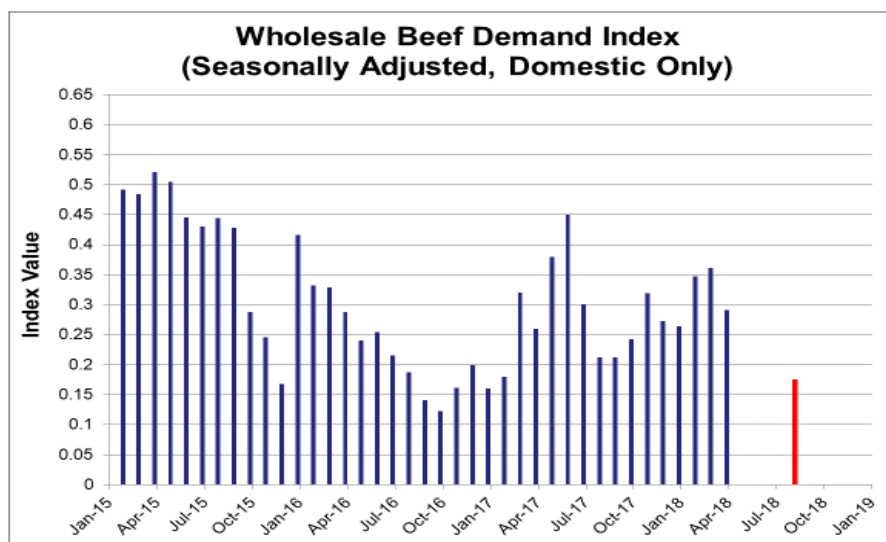
But when I don my special glasses, the chart of the Five Area Weighted Average Steer price looks to me as though it may have just completed a three-week correction in a downtrend that started in the middle of February.... and will be followed by another extended leg downward. There seems to be a decent chance that somewhere in the midst of this sharp decline in the cash market there will be another test of major support. Besides, at this point we're only

guessing about where the bottom in the cash market will be. My guess is \$110 per cwt; but how confident can I be that packer margins will not explode into uncharted territory?

Here's another consideration. Let's say that \$110 *will* be the absolute low. That low is likely to occur in early July, I think, given that the cash market topped out relatively early this year. It is also likely that the August contract will still be trading at a discount at that time. Last year, the August discount was roughly \$3 per cwt in the first week of July; but in 2016 it was nearly \$8, and in 2014 it was in excess of \$5. It is not difficult to envision an August futures market that is still hanging around current levels two months from now.

Though I try to ignore the devil perched on my right shoulder, I realize that I don't really need to wait for August cattle to drop all the way down to \$102.00 in order to make this trade work. I am willing to risk more than the 50 points or so that a purchase at \$102.00 would afford. However, *will* wait for another attempted sell-off, such as occurred yesterday. This is not a market in which I would want to buy on strength. And so, I will aim for something between \$102.00 and \$103.00. That's about as precise as I can be right now.

For reassurance of the notion that August cattle are vastly undervalued, I turn to the futures-implied demand index as of today's close. When I look at this picture, I am making two key assumptions, both of which I regard as quite reasonable. One is that steer and heifer kills will average in the neighborhood of 505,000 at that time; the second is that packer margins will approximate those of a year earlier, at \$180 per head in the spot market (after all, the threat of encroachment on practical slaughter capacity should have passed by then). Under those assumptions, the board is pricing in a massive decline in wholesale beef demand. In the picture below, the blue bars are actual measurements through April, and the lone red bar represents the futures-implied value in August:



Forecasts:

	May*	Jun	Jul*	Aug	Sep*	Oct*
Avg Weekly Cattle Sltr	646,000	665,000	624,000	637,000	620,000	627,000
Year Ago	606,400	637,900	603,800	633,800	624,400	629,500
Avg Weekly Steer & Heifer Sltr	519,000	536,000	499,000	506,000	487,000	488,000
Year Ago	490,600	514,200	488,800	511,000	502,100	500,900
Avg Weekly Cow Sltr	115,000	116,000	114,000	120,000	122,000	129,000
Year Ago	104,600	111,000	104,400	111,000	111,200	117,800
Steer Carcass Weights	855	864	877	888	899	905
Year Ago	837.8	854.0	868.5	884.6	896.0	897.8
Avg Weekly Beef Prodn	516	536	507	521	511	518
Year Ago	477.6	509.6	487.6	517.9	515.8	518.4
Avg Cutout Value	\$223.50	\$222.00	\$211.00	\$211.00	\$207.50	\$206.50
Year Ago	\$238.12	\$238.48	\$209.64	\$196.81	\$192.17	\$197.04
5-Area Steers	\$121.50	\$114.00	\$112.50	\$117.50	\$115.50	\$117.50
Year Ago	\$136.78	\$126.59	\$118.41	\$110.72	\$106.83	\$112.08

*\*Includes holiday-shortened weeks*

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