

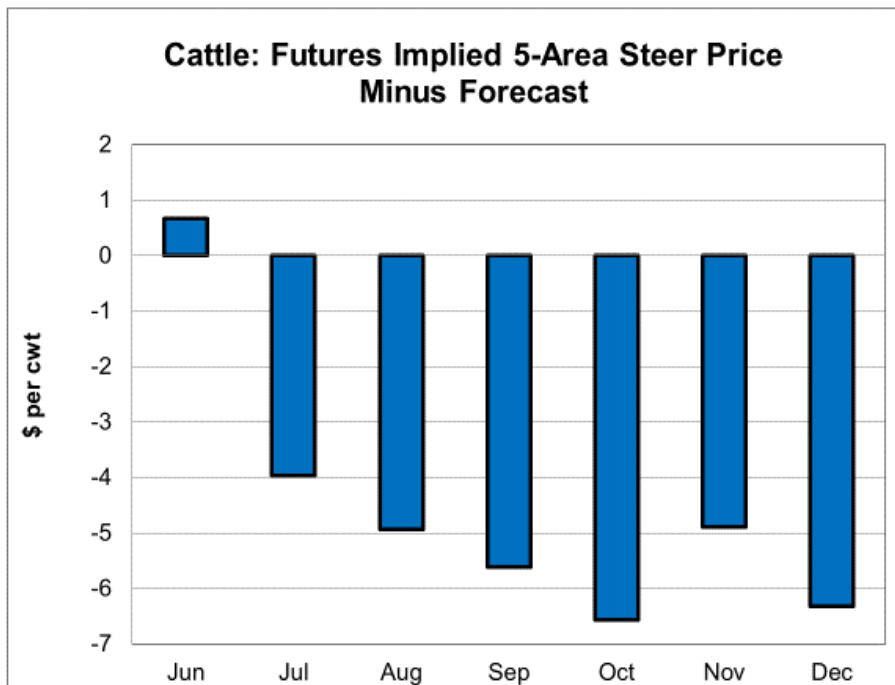
# Trading Cattle

## .... from a meat market perspective

A commentary by Kevin Bost

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June 12, 2019



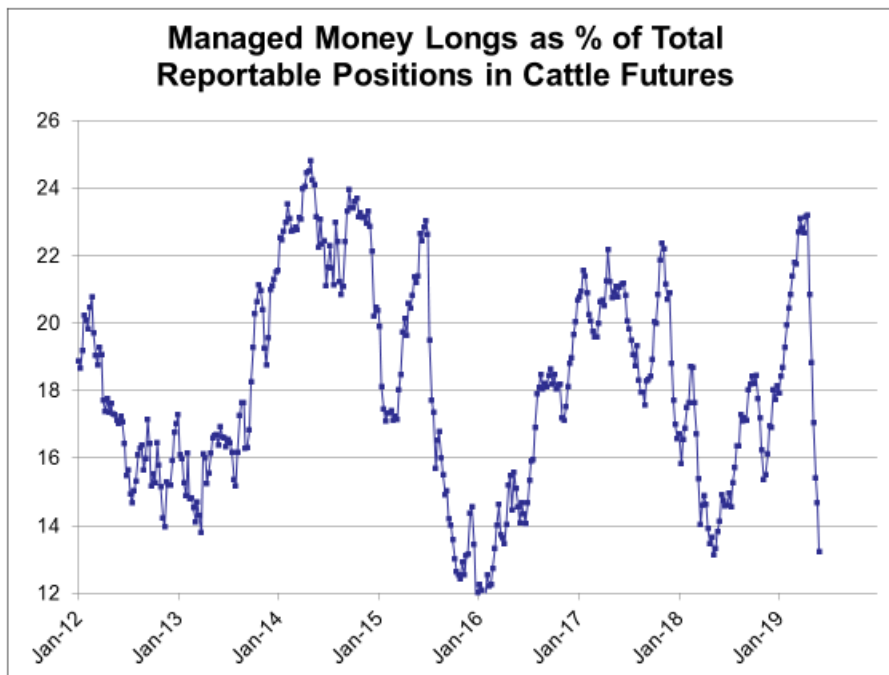
I am convinced that the August contract has bottomed out for good, and there is a good chance that the October and December contracts have established major lows as well. I cite the

probability that while the low in the cash cattle market has probably not yet been established, it is likely only about two weeks away. Close enough. Also, the long position among managed money traders has dwindled down to its lowest level since mid-May 2018. And not least of all, last Friday's sell-off gave the market a great opportunity to begin another leg down, which is emphatically rejected. That means something, doesn't it?

Objectively, the cash cattle market appears to be headed for an average of \$113-something in August. My rationale is that the monthly wholesale demand index at that time will stand modestly above its recently depressed status but well below the readings in February, March, and April. Expressed in English, I am saying that demand for beef will decline seasonally from May to August, as usual; but this time around, the decline will be less than normal--simply because the month of May turned out to be a conspicuous weak spot which had everything to do with short-term cyclical factors and little to do with any major deficiency in consumer-level demand.

With weekly steer and heifer kills running in the 520,000 range (vs. 513,000 a year earlier), that would place the combined Choice/Select cutout value between \$215 and \$216 per cwt in August. Finally, I am willing to assume that spot packer margins will be slightly wider than a year earlier, after peaking later this month and narrowing through July. Why? Well, just because that has been the clear pattern in recent years. In the last four years, margins narrowed by anywhere from \$36 to \$153 per head between June and August; My guess is that this year's drop will amount to about \$65.

A more pessimistic scenario would include the assumption that the decline in wholesale beef demand from May to August will only match the 15-year average (i.e., that the seasonally adjusted demand index will remain perfectly flat); and that packer margins will somehow maintain at an unprecedented \$300 per head. The all-time record for the month of August was set last year at \$248. This combination would land the combined cutout value at \$211.50 and the cash cattle market at \$107.50.



Given the current market psychology (no one likes to be long of August cattle), I think we can expect August futures to remain deeply discounted to the cash cattle market.

The greatest discounts that have prevailed during the month of July have been \$5.58 and \$5.60, recorded in 2014 and 2016. During the month of August, in each of the last four years the spot contract has averaged between \$1.25 and \$1.80. Thus, if the cash cattle market does indeed average near \$113 in August, then we should expect settlements in the August contract to average about \$111.50.

And so my upside target in August cattle is \$112.00. This price happens to be near a 50% retracement from the contract high to contract low (\$111.72).

The obvious place for a stop-loss against any long position in the August contract is \$102.30. I hope to build a sizeable position as closely to that number as possible. At this point, I could not rule out a “double-back” to last Friday’s low (\$103.05). But the ten-day moving average this morning passes through about \$104.75, and I plan to begin my scaling-in strategy at that point. With a \$112.00 objective and a risk down to \$102.00, that would present a profit-to-risk ratio of 2.6 to 1....worth a bet when the fundamental picture is as compelling as it is in this case.

Finally, you might wonder why I am not talking about the October contract instead of the August. It’s a good question, and I am indeed watching this alternative closely. But at the moment, the October forecast involves considerably more guesswork (especially in regard to beef demand), and I would prefer to wait until May placements are “outed” on the 21<sup>st</sup> of June.

Forecasts:

	Jun	Jul*	Aug	Sep*	Oct	Nov*
Avg Weekly Cattle Sltr	658,000	626,000	643,000	632,000	639,000	629,000
Year Ago	654,000	623,900	643,400	632,200	641,500	627,400
Avg Weekly Steer & Heifer Sltr	531,000	505,000	519,000	509,000	510,000	502,000
Year Ago	526,100	499,100	512,600	504,500	505,500	498,700
Avg Weekly Cow Sltr	115,000	110,000	113,000	112,000	118,000	118,000
Year Ago	116,200	114,000	119,600	117,100	125,000	119,400
Steer Carcass Weights	863	878	892	904	909	909
Year Ago	857.5	870.0	884.8	897.0	898.0	901.3
Avg Weekly Beef Prodn	529	509	529	526	533	526
Year Ago	523.2	503.3	525.3	522.0	528.0	519.1
Avg Cutout Value	\$221.00	219.5	\$215.50	\$209.00	\$210.50	\$213.50
Year Ago	\$217.10	\$204.61	\$207.50	\$204.18	\$205.70	\$211.78
5-Area Steers	\$112.00	\$116.00	\$113.50	\$112.00	\$114.00	\$116.50
Year Ago	\$110.39	\$111.87	\$110.02	\$109.89	\$112.06	\$114.79

\*Includes holiday-shortened weeks

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