

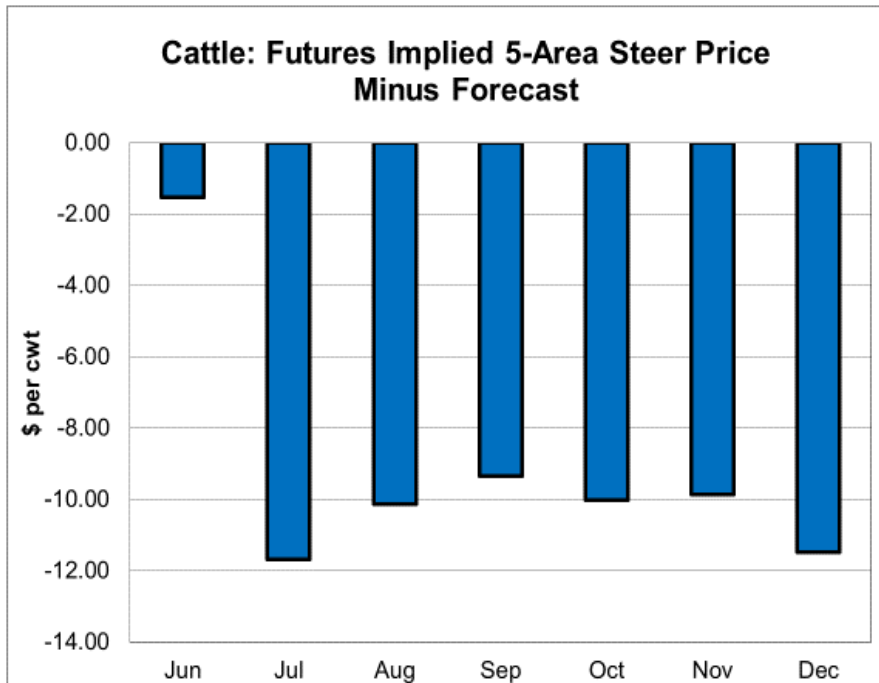
# Trading Cattle

## .... from a meat market perspective

A commentary by Kevin Bost

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June 2, 2019



I lost money holding the long August / short June cattle spread, but it wasn't because the cash markets performed unexpectedly. Indeed, both are about where I had expected them to be on the first of June. My error was in thinking that

in a downtrending cash cattle market, the front end of the board would lose ground to the back end, especially since the latter appears to be vastly undervalued. It turns out that not too many people share my opinion (about the board being underpriced, I mean)....not many at all, in view of the price action at the end of this past week.

The August contract has now become cheap enough that I am willing to buy it outright. Up to this point I had been waiting for some sort of technical confirmation that the market had bottomed, and obviously, that confirmation has yet to be delivered. And so I am, quite plainly, trying to "pick a bottom". This requires the placement of a stop-loss trigger at a technically insignificant price, which in this case will be 200 points below my average entry price.

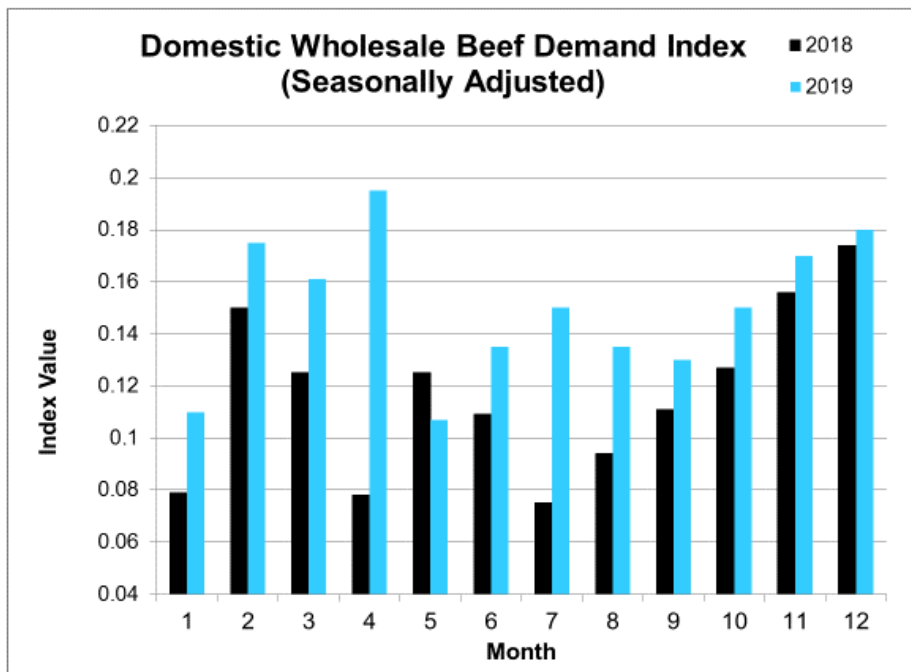
Buying into a declining market in anticipation of a major bottom is not my standard *modus operandi*. I am willing to make an exception in this case for several reasons.

One is that while there is further downside potential in the cash cattle market (which will be facilitated by this breakdown on the board), it looks as though the bottom may not be more than four weeks away. I am assuming that the futures market will bottom out before the cash market, as is most often the case. On this point, I should also add that cutout values are likely to gain ground through the month of June, but packer margins should widen substantially at the same time.

Secondly, the downtrend is becoming a little “long in the tooth”, having lost more than \$17 per cwt over the course of the last 29 trading days. In the process, the long position among managed money traders has gone from a very big 23.2% of the total reportable position down to a very small 14.7%; that was as of last Tuesday, and it has likely fallen further since then. Thus, *unless fund traders now pile into the short side*--I am well aware of this possibility--the fuel for another major leg downward has been spent.

And thirdly, the August contract has dropped into a price zone that is at the extreme end of the probability curve....if I am interpreting the fundamental signals correctly, that is.

I'll expound. The most objective forecast that I can muster places weekly steer and heifer kills at 519,000 in August, up from 513,000 a year earlier. It places spot packer margins at \$255 per head, compared with \$237 in May and \$248 a year earlier. And it places the seasonally adjusted beef demand index at .135, which is slightly below the year-to-date average. To put this index value in proper perspective, I'll have to show you the graph once again:



This combination lands the combined Choice / Select cutout value at an average of \$216.50 per cwt in August, and the Five Area Weighted Average Steer price at \$114.25.

OK, so let's assign some bearish extreme values to each of these variables. Let's go with weekly steer and heifer slaughter at 530,000, which would require an extraordinarily aggressive marketing rate; it would also match the rate of slaughter in the four non-holiday weeks of May. At the same time, let's assume that the demand index shows *no* improvement from its depressed reading in May (.107). And finally, let's place the spot packer margin at \$300 per head--arbitrarily chosen, but clearly high. Plugging these values into the formula simultaneously yields a combined cutout value of \$207.75 and a cash cattle market of \$105.50. QED.

Because of the extraordinary profit potential, I am willing to make several attempts at this trade, if need be. The milestones on the way back up are clearly marked at \$106.22 and \$109.92. The next development, though, will be the establishment of a new, major support level against which a more aggressive position can be built.

Forecasts:

	Jun	Jul*	Aug	Sep*	Oct	Nov*
Avg Weekly Cattle Sltr	654,000	626,000	644,000	632,000	640,000	630,000
Year Ago	654,000	623,900	643,400	632,200	641,500	627,400
Avg Weekly Steer & Heifer Sltr	530,000	505,000	519,000	509,000	511,000	502,000
Year Ago	526,100	499,100	512,600	504,500	505,500	498,700
Avg Weekly Cow Sltr	113,000	111,000	114,000	113,000	119,000	119,000
Year Ago	116,200	114,000	119,600	117,100	125,000	119,400
Steer Carcass Weights	864	879	893	905	910	910
Year Ago	857.5	870.0	884.8	897.0	898.0	901.3
Avg Weekly Beef Prodn	527	510	530	527	535	527
Year Ago	523.2	503.3	525.3	522.0	528.0	519.1
Avg Cutout Value	\$223.00	\$220.00	\$216.50	\$208.50	\$210.00	\$214.50
Year Ago	\$217.10	\$204.61	\$207.50	\$204.18	\$205.70	\$211.78
5-Area Steers	\$112.50	\$116.50	\$114.00	\$111.50	\$113.50	\$117.00
Year Ago	\$110.39	\$111.87	\$110.02	\$109.89	\$112.06	\$114.79

\*Includes holiday-shortened weeks

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