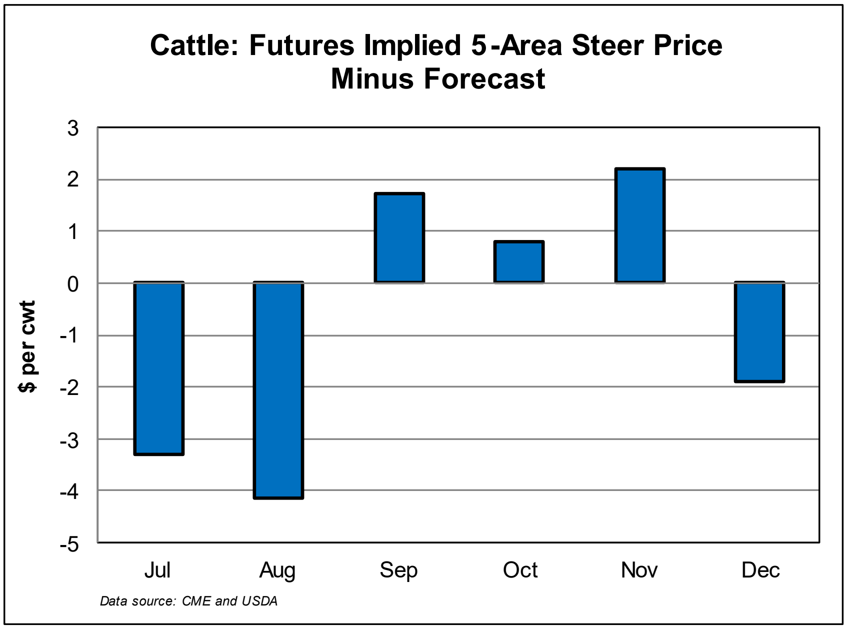
Trading Cattle
…. from a meat market perspective
A commentary by Kevin Bost

June 21, 2021



I would say that I am mildly interested in the long side of August cattle. To get straight to the bottom line, I intend to buy this one in modest quantity at $119.80. I came up with this number by starting with the stop-loss trigger, which would be at $117.20, a tick below the June 8 low; there is no meaningful support level above that price. The upside objective would be $125.00. And so in order to bring the potential profit-to-risk ratio to a barely acceptable 2:1, the entry point would have to be $119.80. Very simple.

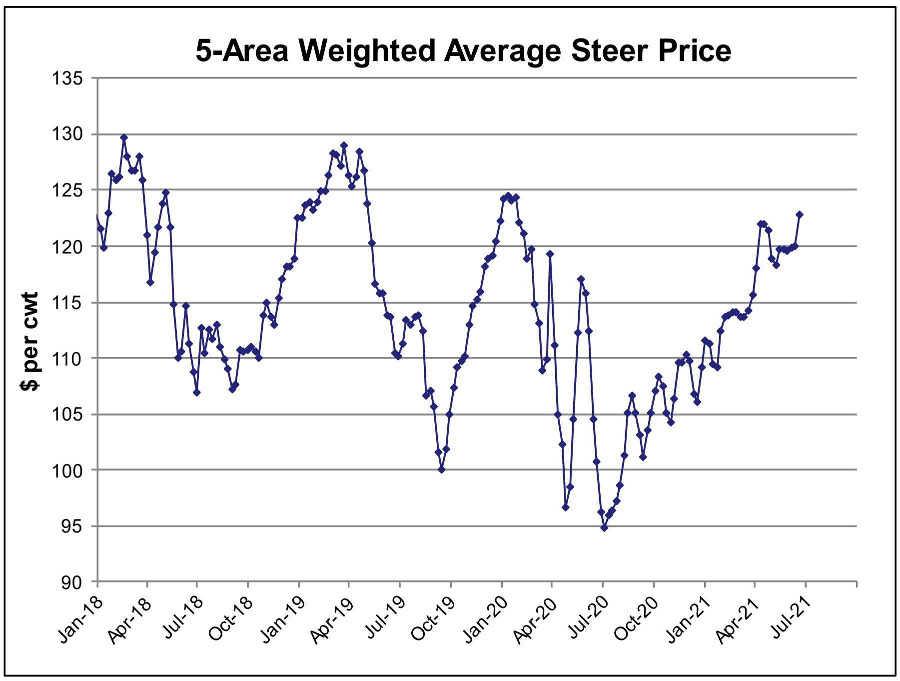
I view this market as a wide, sideways trading range bounded essentially by $116 on the low side and $126 on the high side. Accordingly, a trade from the long side would be regarded as a short-term play, an attempt to catch it below the midpoint of the range and hoping to capture a move back up to the upper boundary (or close to it).

I must say that I was surprised and impressed that packers: a) bought a lot of cattle in the negotiated spot market during the week before last (the week ended June 12, the greatest volume since last November); and b) paid substantially higher prices for cattle last week (the Five Area Weighted Average Steer price was up $2.81 per cwt). Why did they do this, if available cattle supplies were still outnumbering industry-wide slaughter capacity, and if boxed beef prices are teetering on the edge of a cliff?

The Conspiracy Theorist in me says that this more aggressive posture may have been a response to (yet another) pending investigation of excessive concentration in the beef packing industry. The heat has been turned up a notch, it was announced last week that lawmakers are creating a special investigator's office within USDA to address concerns about anti-competitive practices in the meat and poultry. But this seems like a bit of a "stretch" to me.

The more naïve yet more rational-thinking Market Analyst in me suggests that packers need cattle and are building a paper inventory around them as they see their "windfall"-type margins starting to erode within the next few weeks. If this is the case, then it is a major development in the cattle market. It could be signaling an upcoming shift in bargaining position between packers and cattle feeders which, as you know, has been the primary bearish influence in the live cattle market for the past two months. I had suspected that this change might not take place until August, but it makes some sense that it could happen earlier, considering that the inventory of cattle on feed 120 days or longer will take a sizeable step downward in July. [That step will not be taken in the 150-day inventory until August.] And although packer margins in the spot market remain extremely wide, they did drop more than $100 per head last week.

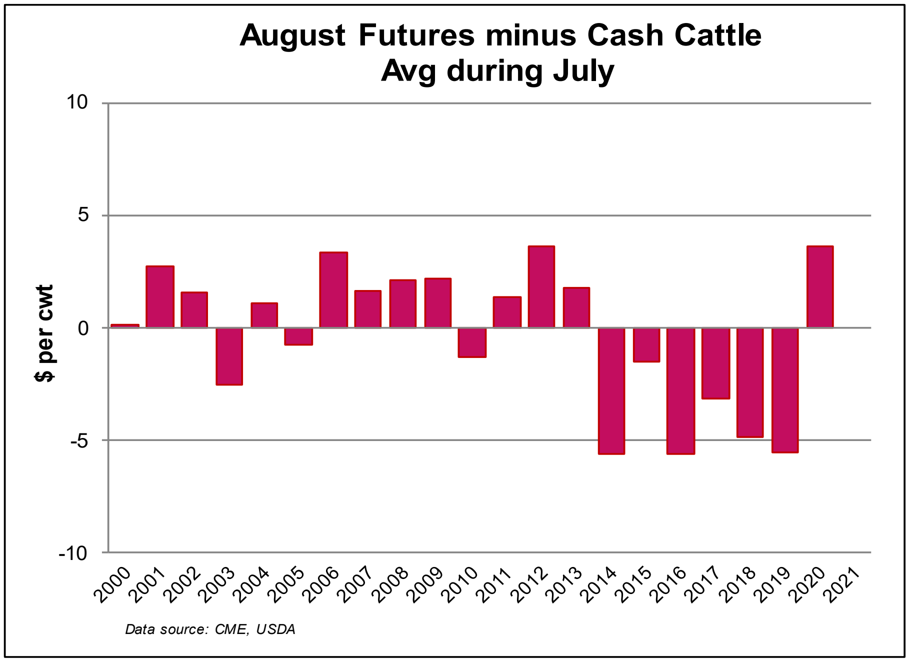
Either way, the chart of the Five Area Weighted Average Steer price has taken on a rather bullish appearance:



Simply reading this as a chart of Commodity X, without taking any additional information into account, one could conclude that $120 will now function as a major support level, since the market spent five weeks at that location before beginning another leg up.

It seems clear to me that the primary undercurrent that will drive cattle prices over the next several months will be a shift in margins away from the packer and back toward the retailer and the cattle feeder. The result will be higher retail beef prices; softer demand for beef at the wholesale level; lower wholesale beef prices; and steady or higher live cattle prices. Of course, the rate at which these shifts occur will be critical. My guess is that cash cattle prices will move sideways between $122 and $125 per cwt from now through the end of July.

The relationship between cash cattle prices and August futures during the month of July is a tough one to call. As I show in the graph at the top of the next page, the basis history seems to leave open the possibility of anything from a $2-3 futures discount to a $2-3 futures premium.



Forecasts:

	Jul*	Aug	Sep*	Oct	Nov*	Dec*
Avg Weekly Cattle Sltr	633,000	647,000	635,000	642,000	638,000	602,000
Year Ago	630,500	645,300	636,500	645,000	634,600	583,800
Avg Weekly Steer & Heifer Sltr	504,000	513,000	500,000	498,000	496,000	465,000
Year Ago	508,700	520,600	506,200	507,700	499,100	455,500
Avg Weekly Cow Sltr	118,000	122,000	124,000	132,000	132,000	127,000
Year Ago	111,200	113,400	119,000	126,300	125,700	119,600
Steer Carcass Weights	910	922	934	941	942	937
Year Ago	901.0	910.3	921.0	928.5	924.5	919.6
Avg Weekly Beef Prodn	527	542	538	543	542	509
Year Ago	524.0	537.9	534.3	542.5	532.7	489.1
Avg Cutout Value	$246.00	$246.00	$238.00	$234.00	$236.00	$239.00
Year Ago	$201.66	$214.29	$218.06	$208.35	$224.87	$215.26
5-Area Steers	$123.00	$125.00	$121.50	$124.50	$125.50	$131.00
Year Ago	$96.62	$104.52	$104.01	$106.27	$108.94	$108.66

Includes holiday-shortened weeks

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