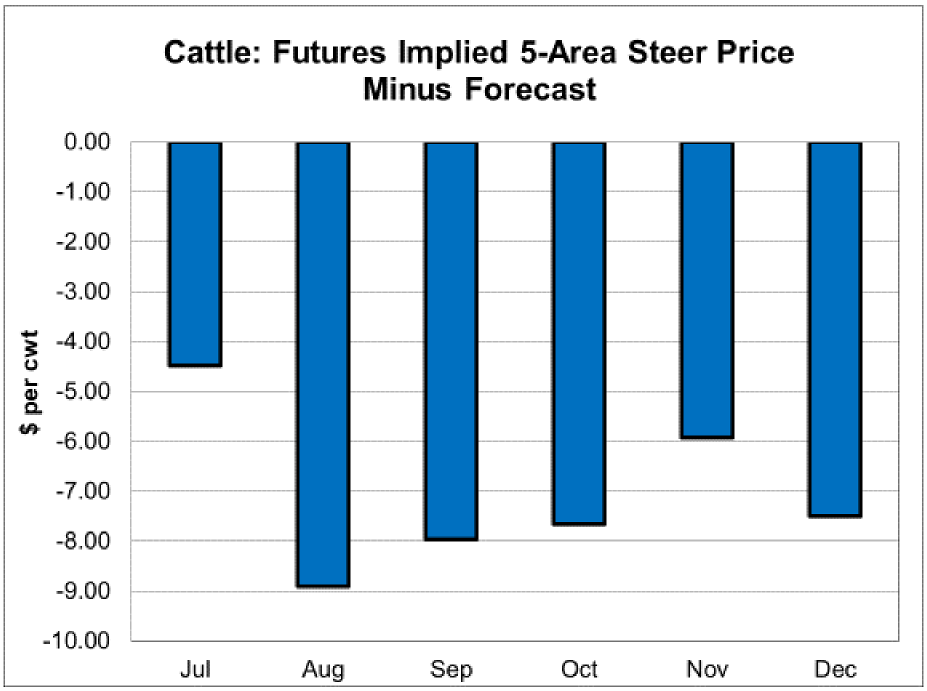
Trading Cattle
…. from a meat market perspective
A commentary by Kevin Bost

June 23, 2019



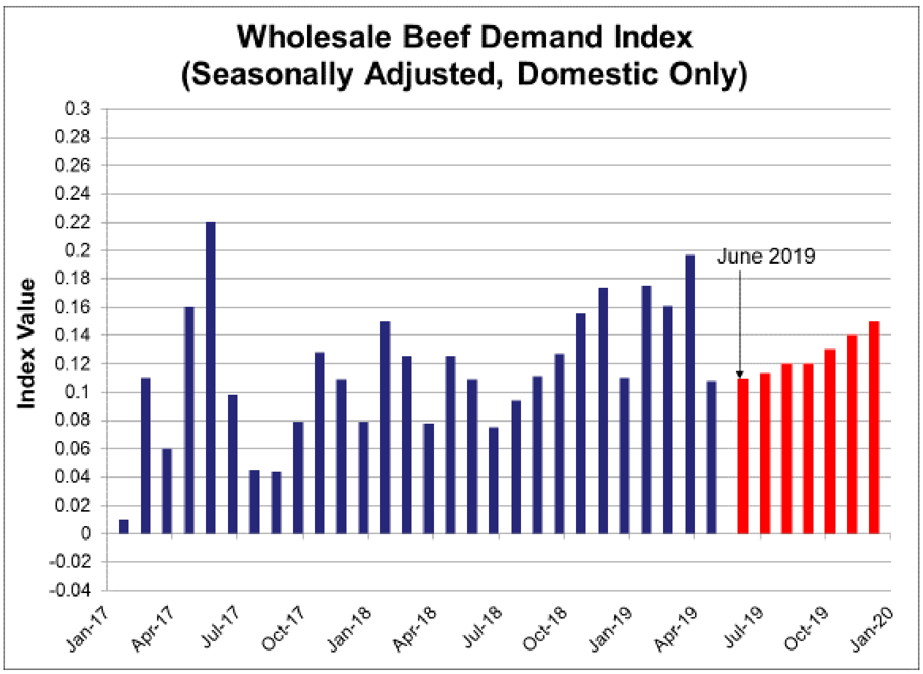
I was convinced that August cattle had established their ultimate bottom on May 31 at $102.30, but obviously, I was wrong about that. And so now I face a familiar dilemma: I hold a moderate investment in what appears to be very valuable property, but the market is telling me that there is something wrong with my valuation assessment.

I would do well to listen, even though the cash market is behaving pretty much as I had expected. This past week's weighted average steer price was approximately $110.45, and this coming week could be the packer's best--and last--opportunity to get cattle bought cheaper, ahead of the shortened holiday schedule. I have to remind myself, though, that the futures market often influences the cash trade, and it could, in this case, press cash cattle prices below last summer's low ($106.87) before it's all over.

I am also respectful of the developing bear flag on the daily chart of the August contract. If I am measuring correctly, the objective of this formation is just above $100.00. [The most recent leg down started at $109.40 and finished at $102.30, amove of 710 points; the current leg down started at $107.17, and a 710-point decline from that point would carry it down to $100.07.]

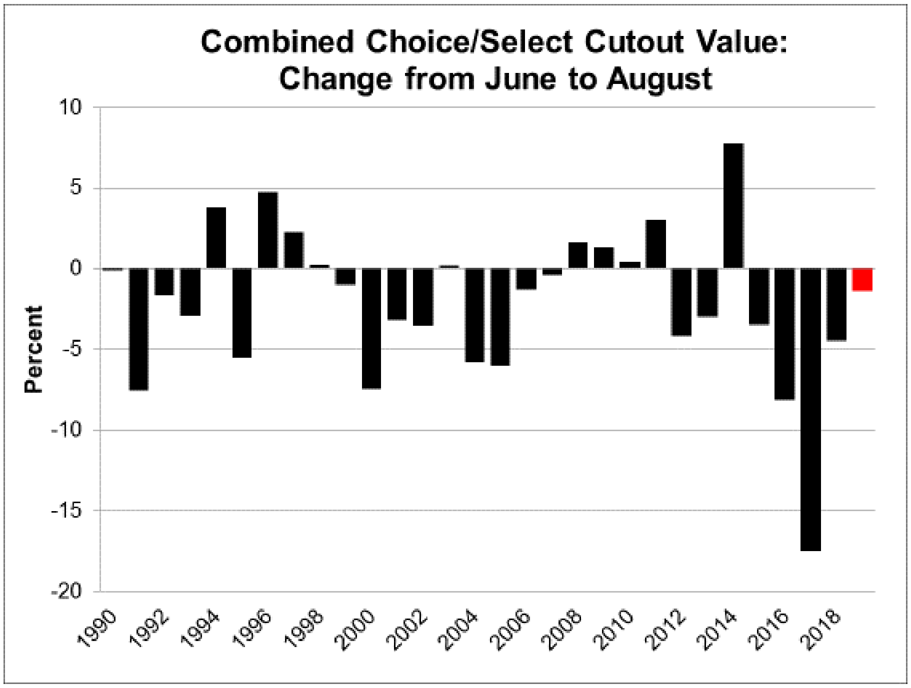
Before I leave the subject of technical considerations, I should also mention that there is very little in the way of potential long liquidation among managed money traders. However, there is plenty of room for them to expand their short position. At its most recent peak (June 2018), managed money shorts comprised 11.9% of the total reportable position; as of last Tuesday, this percentage stood at 6.7%.

In my best estimation, though, the futures market appears to be greatly undervalued. My focus remains on the August contract, because there are fewer unknowns to assimilate. Sure, the beef market will probably trend downward from now until the end of July, when the next low point can be expected. But really, how much ground can we expect it to lose? I take my lead from the demand measurements.



It still looks as though the seasonally adjusted wholesale demand index registered a short-term cyclical low in May, and it has practically remained at that same level here in June. In five of the six months prior to May, the readings were robust. I doubt that there has been any sort of long-lasting, deep-seated downward adjustment in "core-level" demand. If the major trend in demand is sideways (which seems unequivocal, looking at the chart), then one would naturally anticipate a move back toward the upper end of the range from here. I regard the slight and gradual upturn shown in the picture above as conservative, and yet it suggests that the combined Choice/Select cutout value will average somewhere near $214.50 per cwt in August, only $1 below Friday's quote. Another, more concrete reason to expect a relatively mild decline in the cutout during July is simply that Choice middle meats seem to have considerably less room to fall in the post-holiday trade than they did in the last two years--because there has been no rally in these items since April.

The 1.4% decline in monthly average cutout values that I am forecasting from June to August this time around is really not *that* unusual:



If my beef price forecast is in the right ballpark, then a sustained sub-$110 cash cattle market can only be effected via abnormally wide packer margins. The spot packer margin index averaged $77 per cwt below a year earlier in May, at $236 per head; and it is going to wind up about $30 below a year ago here in June, at $300. Even so, I am building into my price forecast an index of $260 in both July and August, which would be $61 and $12 *above* a year earlier respectvely….once again, pretty conservative. Keep in mind that wider packer margins tend to coincide with stronger beef markets, and narrower packer margins tend to coincide with weaker beef markets.

But even if my forecast of a $112-$113 cash cattle market in August proves to be overly optimistic, how much below $102 can the August futures contract ultimately be worth? Am I *that* far off the mark?

My plan, then, is to obey the foundational rule of money management and step aside until the market either negates Friday's contract-low close or approaches $100.00, whichever comes first.

Forecasts:

	Jul*	Aug	Sep*	Oct	Nov*	Dec*
Avg Weekly Cattle Sltr	629,000	646,000	638,000	646,000	636,000	608,000
Year Ago	623,900	643,400	632,200	641,500	627,400	606,200
Avg Weekly Steer & Heifer Sltr	505,000	518,000	512,000	514,000	504,000	483,000
Year Ago	499,100	512,600	504,500	505,500	498,700	479,400
Avg Weekly Cow Sltr	114,000	117,000	116,000	122,000	122,000	116,000
Year Ago	114,000	119,600	117,100	125,000	119,400	117,700
Steer Carcass Weights	872	884	895	900	900	896
Year Ago	869.0	884.8	897.0	898.0	901.3	893.8
Avg Weekly Beef Prodn	507	527	527	535	527	502
Year Ago	503.3	525.3	522.0	528.0	519.1	497.9
Avg Cutout Value	213.00	$214.50	$206.50	$206.50	$209.50	$209.00
Year Ago	$204.61	$207.50	$204.18	$205.70	$211.78	$211.76
5-Area Steers	$111.50	$112.50	$110.50	$111.50	$114.00	$116.00
Year Ago	$111.87	$110.02	$109.89	$112.06	$114.79	$119.39

**Includes holiday-shortened weeks*

Trading Cattle is published weekly by Procurement Strategies Inc., 99 Gromer Road, Elgin IL 60120. For subscription information, please contact Kevin Bost at (847) 212-7523; or visit our website at www.procurementstrategiesinc.com.