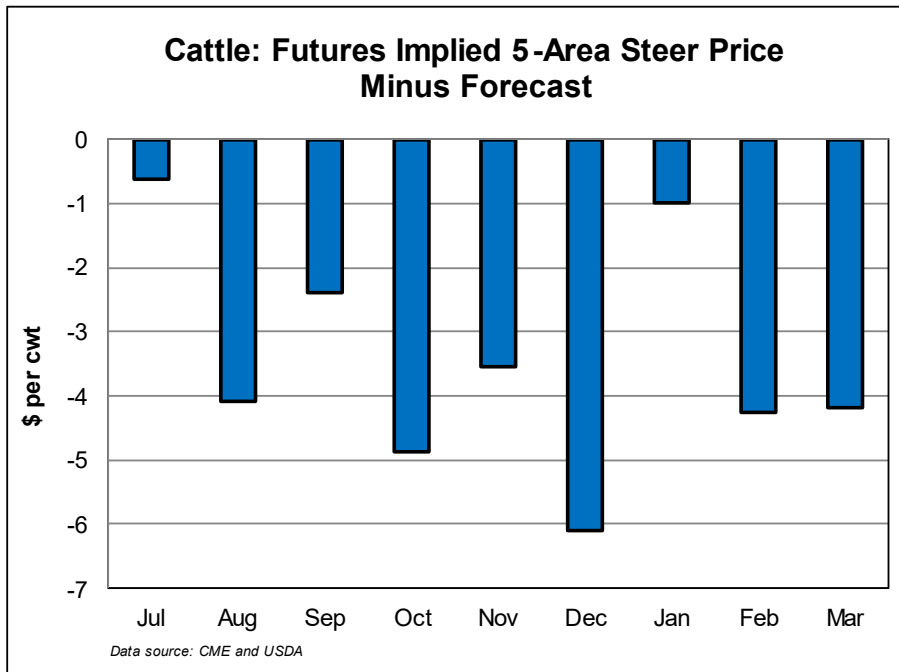


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

July 18, 2021



I hold a moderate long position in August cattle, with a close-only stop below \$118.85—the only reasonable place for it, as best I can tell. I was motivated to buy this market, quite simply, because what appeared to be a major

breakdown on the chart (the drop below \$120.50) garnered no follow-through and in fact, the market turned around and blasted through its ten- and 40-day moving averages. It was, at the time, quite convincing, in a futures contract that I judge to be significantly undervalued.

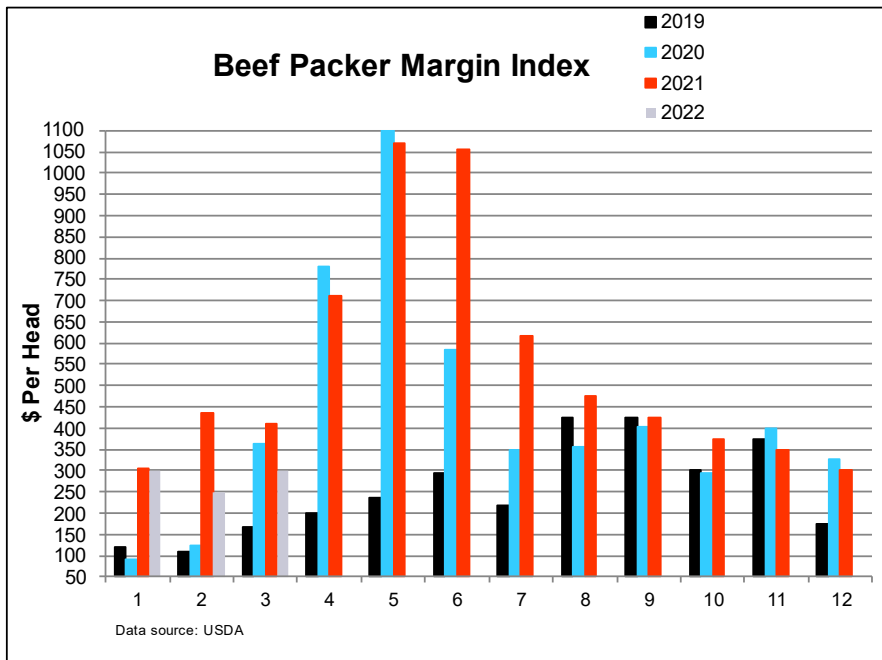
The price action since then has been disappointing. And yet, after three consecutive lower closes, the technical damage has been minor. From Wednesday though Friday of last week, practically all of the trade took place within Tuesday's range (the day of the big rally).

One final technical observation: the outright long holdings among managed money traders have been reduced to 15.9% of the total reportable position in cattle futures, which is the approximate midpoint of its range over the past twelve months. The bullish spin on this number is that this percentage is the smallest it has been since the middle of January. In any case, the potential long liquidation from trading funds is not burdensome. If it were, then the board would have fallen apart after it closed below \$120.50....wouldn't it?

The bullish case for cash cattle prices depends almost exclusively on the prospect of narrower packer margins. There will be no help from the beef market any time soon, as

cutout values are likely to lose another \$15 per cwt or so before they “catch”; and that probably won’t happen until we’re halfway through August.

Thus, my long-side bet in the August contract will pay off only if the packer margin index declines from last week’s reading of \$649 per head down to around \$500 within the next three weeks. It is a seemingly tall order, and yet the index *has* dropped at an average rate of \$115 per week since it peaked in early June. My best guess at this point is that at the end of August we will be looking at combined Choice/Select cutout value of \$255 per cwt (compared with Friday’s quote of \$265); a packer margin index of \$500; and a Five Area Weighted Average Steer price of \$125. I have toned down my expectations somewhat, simply due to the lack of enthusiasm on the board late last week.

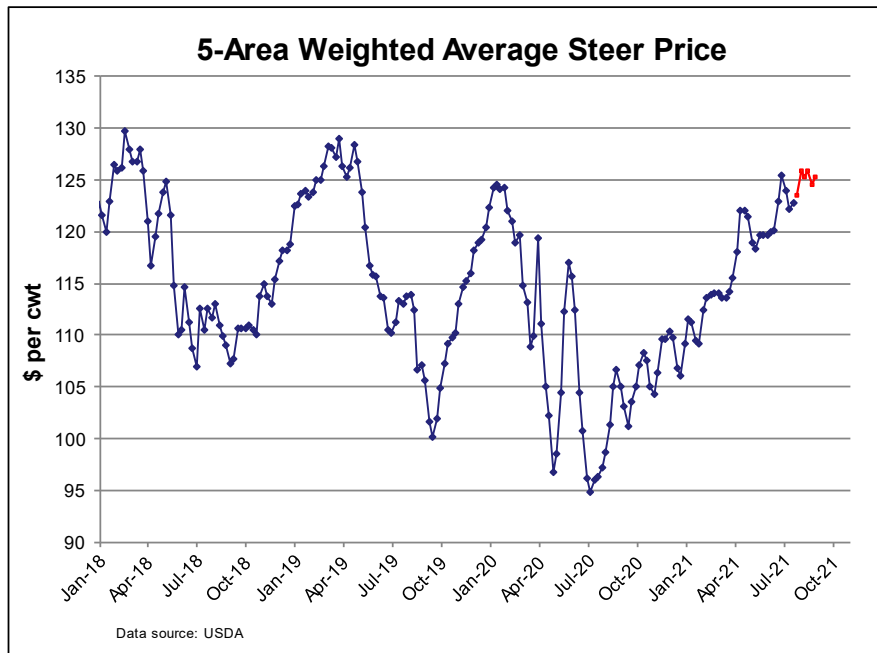


Likewise, the bullish prospects for the October and December contracts hinge mainly on tighter packer margins, as I show in the picture to the left. All the while, I realize that the index values that were perceived as unsustainably wide in “pre-COVID” times

may not be unsustainable anymore, because slaughter/fabrication costs have increased quite a bit since last spring. In other words, a packer margin index value of +\$300 per head might reflect actual packer margins in the spot market of only \$150 or thereabouts. Even so, it seems that with slowly diminishing cattle supplies relative to slaughter capacity, the projections shown in the graph above are realistic.

I am mildly encouraged by the small uptick in the Five Area Weighted Average cash cattle price this past week, as it keeps alive the possibility that it may be establishing support at \$122, which was formerly a significant resistance point. If this is indeed what’s happening, then the trip back to \$125-something should be a quick one.

Finally, the picture on the first page makes me wonder if the December contract might be a better place for a long position than the August contract. It is innately less certain because it is farther down the road, and there is something that tells me it is more risky to buy into a market that is priced at \$130 than one that is priced at \$120. But the technical picture is better-defined in December cattle, with support at \$130.00 and resistance at \$134, and so I will seriously consider this “roll”.



Forecasts:

	Aug	Sep*	Oct	Nov*	Dec*	Jan
Avg Weekly Cattle Sltr	644,000	631,000	632,000	627,000	593,000	634,000
Year Ago	645,300	636,500	645,000	634,600	583,800	655,600
Avg Weekly Steer & Heifer Sltr	510,000	495,000	490,000	485,000	457,000	490,000
Year Ago	520,600	506,200	507,700	499,100	455,500	510,300
Avg Weekly Cow Sltr	123,000	124,000	131,000	131,000	126,000	134,000
Year Ago	113,400	119,000	126,300	125,700	119,600	136,000
Steer Carcass Weights	905	915	922	923	918	912
Year Ago	910.3	921.0	928.5	924.5	919.6	923.5
Avg Weekly Beef Prodn	531	525	526	522	492	526
Year Ago	537.9	534.3	542.5	532.7	489.1	552.8
Avg Cutout Value	\$252.00	\$247.00	\$247.00	\$249.00	\$250.00	\$247.00
Year Ago	\$214.29	\$218.06	\$208.35	\$224.87	\$215.26	\$215.07
5-Area Steers	\$125.50	\$126.00	\$129.50	\$133.00	\$137.00	\$135.00
Year Ago	\$104.52	\$104.01	\$106.27	\$108.94	\$108.66	\$110.61

*Includes holiday-shortened weeks

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