

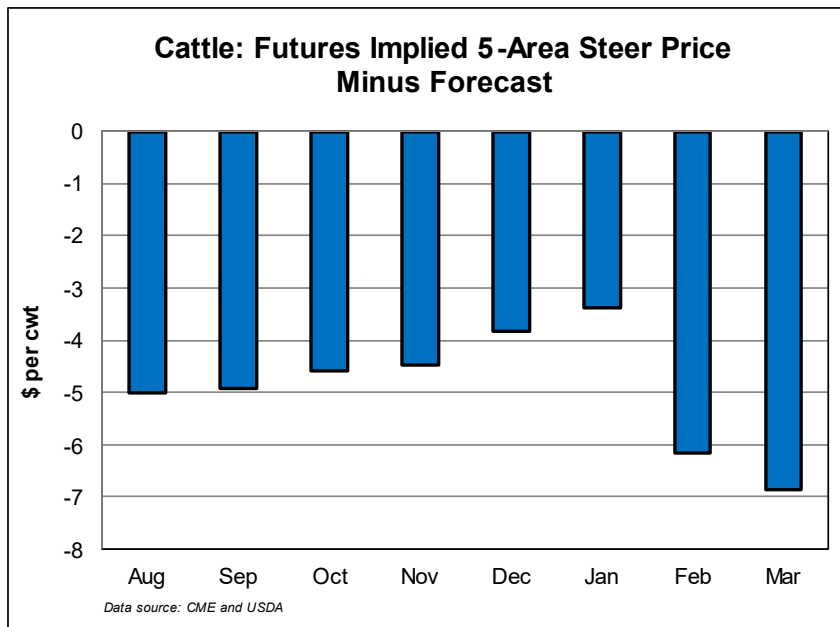
# Trading Cattle

## .... from a meat market perspective

A commentary by Kevin Bost

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July 26, 2021



I remain moderately long of August cattle, risking this trade down to a close below \$118.85. The upside objective is a moving target--\$124.00 at a minimum, but \$128.00 if I can believe my own forecast—which is telling me that the Five Area Weighted Average Steer price will be situated between

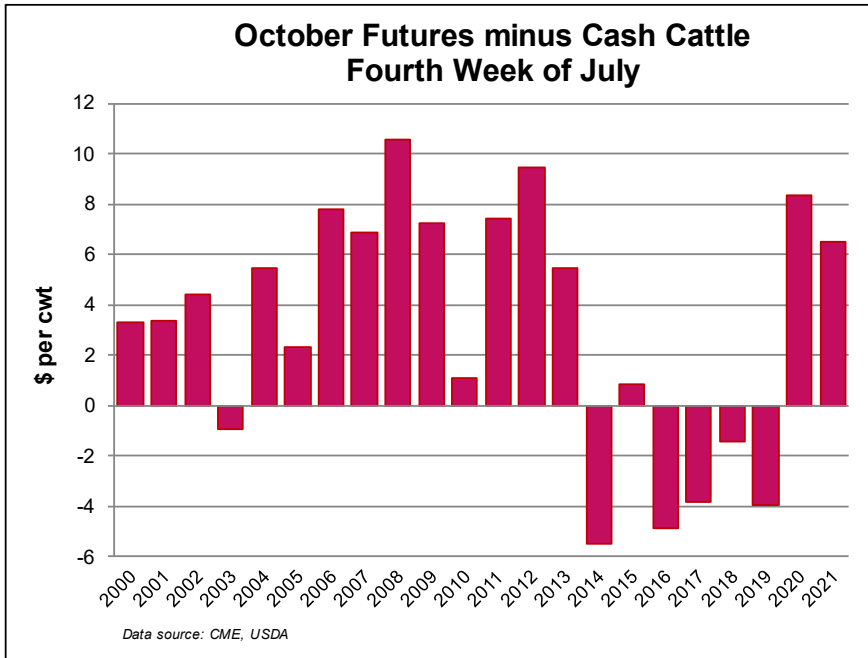
\$127 and \$128 as the August contract goes off the board. I arrive at that number via a combined Choice/Select cutout value of \$260 per cwt cash market (\$3.70 below last Friday's quote) and a packer margin index of \$525 (\$115 below last week's average). Clearly, the outcome of my bet will be decided mainly by the degree to which the spread between cattle and beef prices shrinks between now and then. I should point out that if it does not shrink at all, then a \$260 combined cutout value will align with a cash cattle price of \$119. I'll not go into further detail on the subject of packer margins today, since I have worn out this topic over the past couple of months. Let it suffice to say that at \$525 per head, the margin index would stand \$62 above a year earlier and even \$32 wider than the end of August 2019, immediately after a fire shut down Tyson's big slaughter plant in Holcomb, Kansas.

I must say that I was surprised and mildly disturbed by the approximate \$2 per cwt decline in the Five Area Weighted Average Steer quote this past week. It was not consistent with the theme of tightening front-end cattle supplies, a more competitive environment in the weekly negotiated cattle trade, and narrowing packer margins. But I'm trying not to read too much into this for the moment.

In regard to the front-end cattle supply, it looks to me as though marketing rates in June and so far here in July are what I would call "adequate". The inventory of cattle on feed 150 days or longer is large by historical standards, but it is declining. And the fed cattle slaughter rates that I show in the table at the end of this report assume that marketing

rates will be no better than “par” through the fall—yet sufficient to prevent a significant backlog from developing any time soon.

The October and December futures contracts are carrying noteworthy premiums to the cash cattle market, and I have to think that this condition will eventually cause feedlots to “dig in their heels”, at least to some degree, in the negotiated cattle trade.



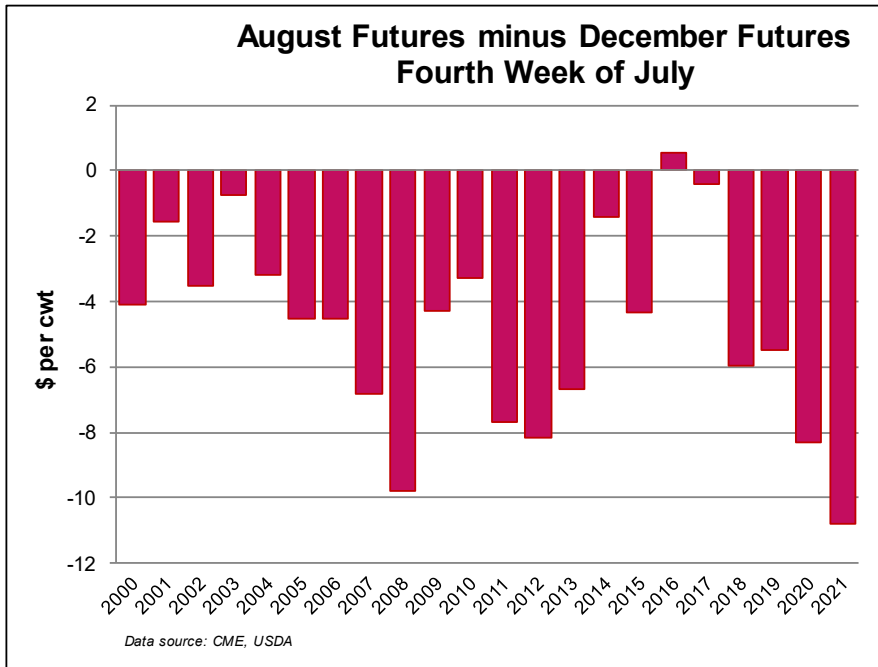
Coming into today's trading session, the October contract stood a little more than \$6 above the Five Area Weighted Average Steer price....not really extreme, but certainly in the upper end of the historical range. The prospect of significantly higher prices

not so far down the road should make *some* difference in the marketing pace, shouldn't it? I don't show the equivalent picture of the August basis, but I noticed something interesting. August futures started out this morning with a premium of about \$1.00 per cwt over the cash market, which is nothing special; prior to 2014, this was considered normal. However, similar to the October basis shown above, during the stretch from 2014 through 2019, August futures were significantly discounted to the cash market in the fourth week of July. What's interesting about this is that in each of these six years, cash cattle prices were lower at the end of August that they were at the end of July. In contrast, in twelve of the 14 years from 2000 to 2013 (when August futures were premium to cash), cash cattle prices were higher at the end of August than at the end of July. And among those 14 years, the average change in the Five Area Steer quote was +\$2.89 per cwt. Maybe it's just a coincidence, but maybe it's not.

I still do not expect anything distinctly positive to come from the beef market any time soon. While forward booking activity did pick up noticeable last week, this activity was probably targeted for September 1 and beyond. In the meantime, it looks as though retail beef featuring will be sparse. However, there are signs that cutout values might be starting to “catch” a little sooner and at higher price levels than I had anticipated. This, of course, is a bullish factor (reflecting favorably on wholesale beef demand), and I have bumped up my cutout value forecasts accordingly.

In view of the uncertainty surrounding the upside potential of the August contract, I am seriously considering a sale of the December contract against one half of my long

position. The reason, quite simply, is because the spread between the two is the widest it has been at the end of July in at least the last 20 years (I didn't bother to back any farther than that, but the point stands). Naturally, I have my eye on \$134.00; if December cattle are able to close above that level, it looks like they would be on their way to \$138.00.



Forecasts:

	Aug	Sep*	Oct	Nov*	Dec*	Jan
Avg Weekly Cattle Sltr	648,000	637,000	643,000	636,000	597,000	635,000
Year Ago	645,300	636,500	645,000	634,600	583,800	655,600
Avg Weekly Steer & Heifer Sltr	513,000	500,000	500,000	493,000	460,000	490,000
Year Ago	520,600	506,200	507,700	499,100	455,500	510,300
Avg Weekly Cow Sltr	125,000	126,000	133,000	133,000	128,000	136,000
Year Ago	113,400	119,000	126,300	125,700	119,600	136,000
Steer Carcass Weights	901	911	918	919	914	908
Year Ago	910.3	921.0	928.5	924.5	919.6	923.5
Avg Weekly Beef Prodn	533	528	533	528	494	525
Year Ago	537.9	534.3	542.5	532.7	489.1	552.8
Avg Cutout Value	\$259.00	\$261.00	\$253.00	\$251.00	\$249.00	\$251.00
Year Ago	\$214.29	\$218.06	\$208.35	\$224.87	\$215.26	\$215.07
5-Area Steers	\$125.50	\$130.00	\$130.50	\$135.00	\$135.50	\$138.50
Year Ago	\$104.52	\$104.01	\$106.27	\$108.94	\$108.66	\$110.61

\*Includes holiday-shortened weeks

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