

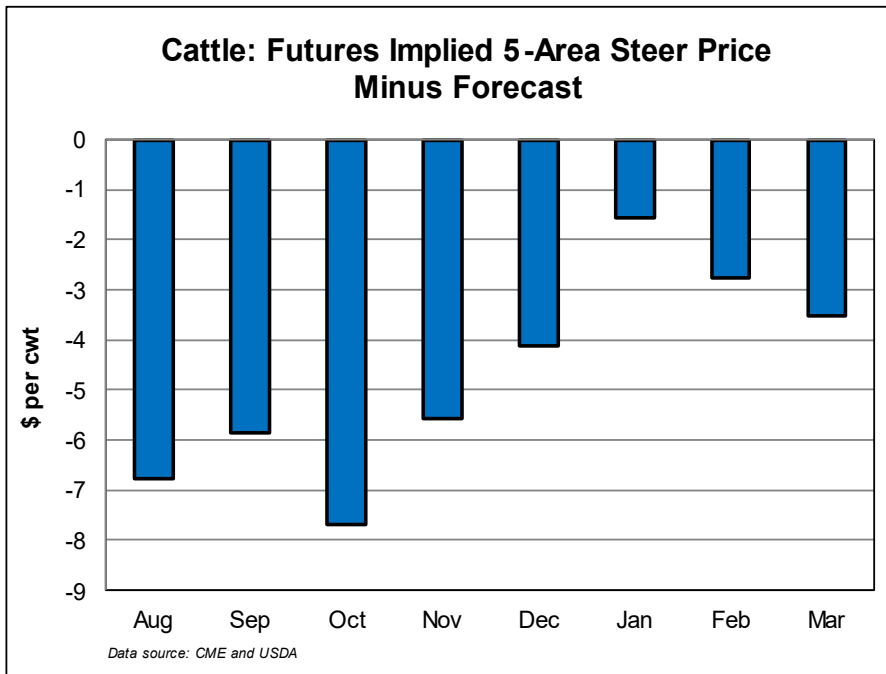
# Trading Cattle

## .... from a meat market perspective

A commentary by Kevin Bost

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August 1, 2021

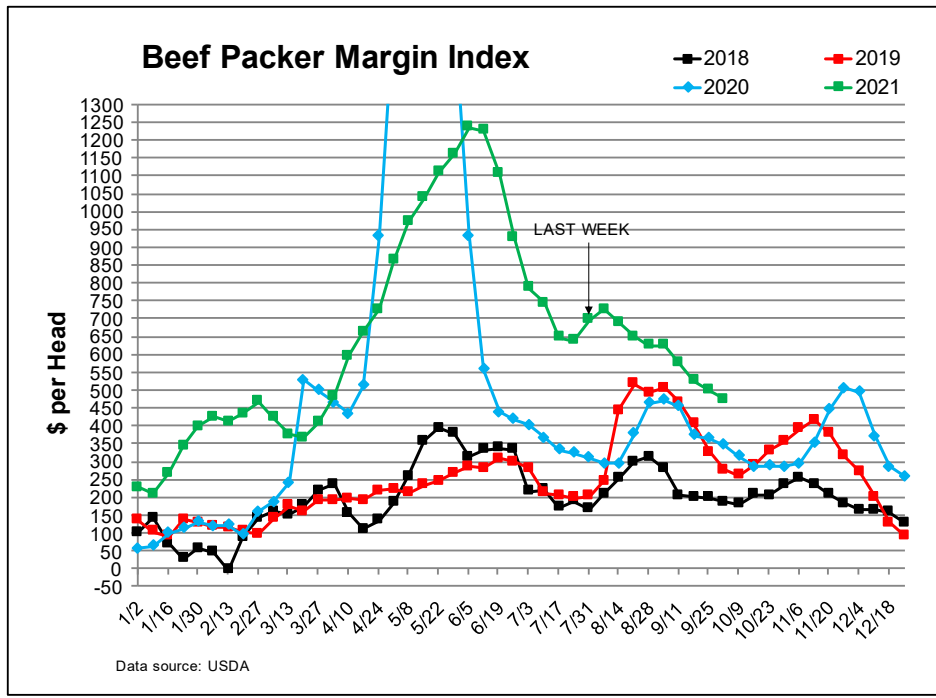


I remain moderately long of August cattle with a close-only sell stop at \$119.20 per cwt and an upside target of approximately \$128. Last week it seemed that the target could lie anywhere between \$124 and \$128, but today it seems more clear—

using some peculiar reasoning. Basically, my stance is that if the cash market is able to start gaining meaningful ground at this point, it probably will maintain its upward momentum through the end of the month (and beyond). In other words, if this trade is going to be successful, it will be greatly so....a sort of “all or nothing” proposition, if you will. And I should add that if this trade is not successful in the August contract, then I am willing to roll it into the October contract.

It's all about packer margins. Beef cutout values have actually found support at significantly higher price levels than I had anticipated, and they managed to gain more than \$11 per cwt this past week—a condition that normally would have been “friendly” to futures prices, especially because I don't think the strength in the beef market was generally anticipated. Yet, both August and October cattle finished on Friday at almost exactly where they opened last Monday morning. The Five Area Weighted Average Steer price, meanwhile, was barely better than steady, thus spot packer margins widened for the first time since the first week of June.

Obviously, packer margins have not narrowed as quickly as I had expected, although the trend is distinctly downward. Most confounding about this is that I have a very hard time understanding how such wide margins have been maintained. Actual spot margins are probably somewhere between \$550 and \$600 per head.



It is especially difficult to explain in light of the fact that carcass weights are not increasing at a normal seasonal pace (they are up only nine pounds from their seasonal low, whereas they are typically 20

pounds above the low by now); and in light of the fact that the percentage of cattle grading Choice or better is declining counter seasonally. It could be that the front-end supply contains a high percentage of young, lightweight calves, although there is no statistical evidence to confirm this notion. But whatever reason, these conditions regarding the grade-out and carcass weights are not indicative of a backlog—and yet, packer margins are behaving as though marketings were running behind schedule and cattle were being forced into the “pipeline”.

About all I can do as a trader is to recognize the possibility that packer margins will not decline at all in the weeks ahead; and to make sure that I do not underestimate the extent of the bullish impact on cattle prices, should packer margins resume their downtrend. In the case of the former, a packer margin index of \$700 per head would probably place the cash cattle market at \$124 per cwt at the end of August (there’s that number again!); and at \$750, the cash market would probably land at \$120.50. But in the case of the latter, the prospects are exciting; if the packer margin index were to merely return to where it stood in the week before last, then cash cattle prices would finish the month of August at \$129. And if the margin index were to move back to 2019 and 2020 levels in October, then cash cattle prices would be in the low \$140’s at that time. Is it really that unrealistic?

And so, the challenge is to recognize the signal that the spread between cattle prices and beef prices is on its way downward in earnest. At that point, an increase in my bet from “moderate” to “aggressive” would be warranted, whether it is in the August contract or in the October contract. A move in the Five Area Weighted Average Steer price above \$125.47 (the high for the year so far) might be a more reliable signal than a close above \$124.00 in August futures—although that development would be welcome, too.

Forecasts:

	Aug	Sep*	Oct	Nov*	Dec*	Jan
Avg Weekly Cattle Sltr	650,000	636,000	641,000	633,000	598,000	638,000
Year Ago	645,300	636,500	645,000	634,600	583,800	655,600
Avg Weekly Steer & Heifer Sltr	512,000	498,000	496,000	489,000	460,000	492,000
Year Ago	520,600	506,200	507,700	499,100	455,500	510,300
Avg Weekly Cow Sltr	126,000	127,000	134,000	134,000	129,000	137,000
Year Ago	113,400	119,000	126,300	125,700	119,600	136,000
Steer Carcass Weights	899	909	916	917	912	906
Year Ago	910.3	921.0	928.5	924.5	919.6	923.5
Avg Weekly Beef Prodn	532	526	530	525	494	527
Year Ago	537.9	534.3	542.5	532.7	489.1	552.8
Avg Cutout Value	\$276.00	\$267.00	\$258.00	\$256.00	\$253.00	\$251.00
Year Ago	\$214.29	\$218.06	\$208.35	\$224.87	\$215.26	\$215.07
5-Area Steers	\$127.00	\$131.00	\$134.00	\$136.00	\$136.00	\$137.00
Year Ago	\$104.52	\$104.01	\$106.27	\$108.94	\$108.66	\$110.61

\*Includes holiday-shortened weeks

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