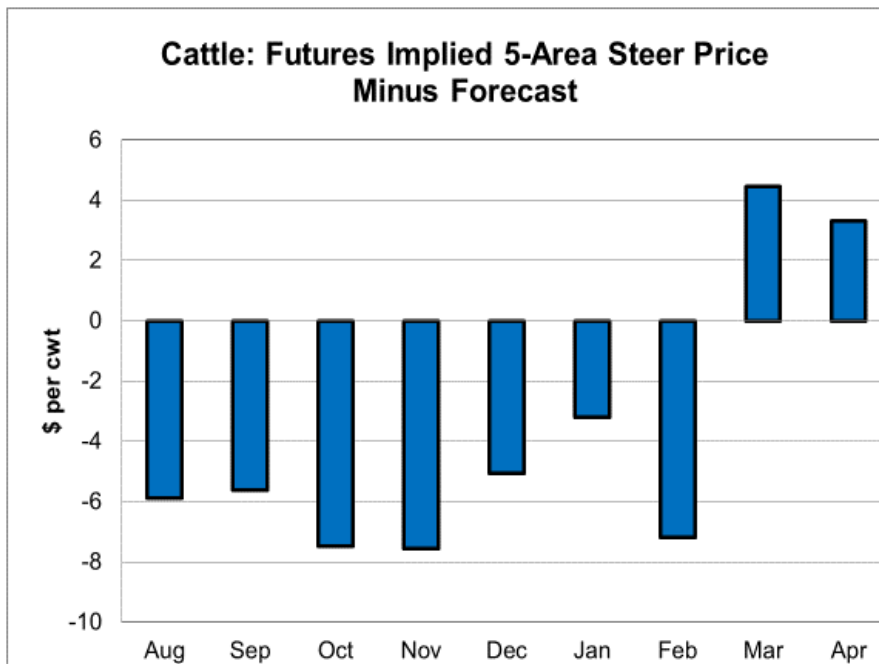


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

August 13, 2018



I continue to hold an aggressive long position in August cattle and contemplating an outright long in the October contract and/or a long October/ short April spread.

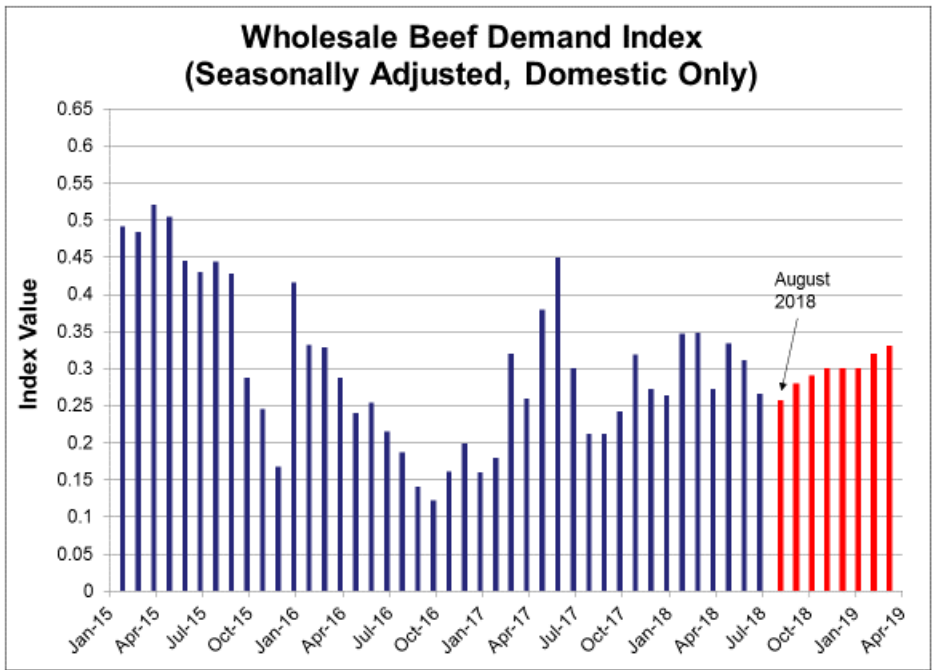
The virtue of keeping my bet in the August is that it should have

a pretty solid floor underneath. In order for the cash market to draw within a dollar of today's closing price on the board—a reasonable basis call for next week—either cutout values would have to lose \$8 per cwt from this afternoon's quote or, if cutout values were to hold steady from here (whereas something higher is more likely), then spot packer margins would have to widen by \$60 per head from this past week's average. The latter is the more likely of two *unlikely* possibilities. My guess is that spot packer margins will narrow slightly, and the Five Area Weighted Average Steer price will move up to \$114.

The unpleasant surprise to me in the cash market in recent days is that beef prices—namely, chuck and round cuts—have not perked up as much as I had expected by now. This was not a consequence of poor demand, however; the wholesale demand index actually increased last week. But the steer and heifer kill jumped 17,000 head to 516,000 (equal to a year earlier), which was quite a bit more than I had anticipated. I have to respect the evidence that front-end cattle supplies may be greater than the statistics indicate, and so I have raised my sights for fed beef production in the near term. But it still looks to me as though steer and heifer kills will slip back to about 510,000 per week through the balance

of August and essentially remain at that level in the three non-holiday weeks of September. In that supply scenario, if demand follows a typical seasonal course, then the combined cutout value should reach a peak next week and then trend slowly downward until the end of September.

In the broader picture, though, wholesale beef demand is due for a short-term cyclical low here in August. My forecasts of monthly average cutout values shown in the table at the bottom of this report—which reflect a fairly stable market—assume that the seasonally adjusted demand index will recover in the fall, but only mildly.



If, for some reason, seasonally adjusted demand were to rebound back to where it stood in May, then we would be looking at combined cutout values centering around \$210

instead of \$205 during September-November, and cash cattle prices traversing between \$115 and \$125. I must say, though, that the direction and status of retail prices and retail margins do not support this more bullish demand outlook.

Still, the October contract appears to be substantially undervalued and worthy of an outright long position. If I did not already have a bet down on the August contract, I would probably buy October cattle right about here, with a very tight stop—i.e., a close below today’s low. My only hesitation would be the likelihood of a declining beef market through the month of September.

It is worth noting that the long side of the cattle market is owned primarily by index traders (including swap dealers), and the short side is owned by commercial hedgers, presumably cattle feeders. Both are “slow movers”, meaning that they typically do not quickly change their positions. I interpret this to mean that there is not a great source of potential long liquidation—or short-

covering—to be triggered by moderately significant technical signals. Therefore, we might very well be in for more of the same “grudgingly upward” price action that has characterized the cattle market for the past three months.

I would approach the long October/short April spread as a proxy for an outright long position. For now, I am holding out for an entry point in the neighborhood of a \$10.50 per discount in the October contract.

Forecasts:

	Sep*	Oct	Nov*	Dec*	Jan*	Feb
Avg Weekly Cattle Sltr	630,000	633,000	623,000	608,000	622,000	618,000
Year Ago	624,400	629,500	625,700	593,800	595,400	594,200
Avg Weekly Steer & Heifer Sltr	497,000	493,000	484,000	477,000	486,000	487,000
Year Ago	502,100	500,900	498,600	472,600	466,400	465,800
Avg Weekly Cow Sltr	122,000	128,000	129,000	122,000	127,000	121,000
Year Ago	111,200	117,800	116,700	111,600	120,400	119,500
Steer Carcass Weights	893	899	901	897	889	882
Year Ago	896.0	897.8	902.6	902.8	892.8	884.0
Avg Weekly Beef Prodn	519	522	516	504	512	507
Year Ago	515.8	518.4	519.2	495.3	492.5	488.1
Avg Cutout Value	\$203.50	\$205.75	\$205.00	\$203.00	\$208.50	\$205.50
Year Ago	\$192.17	\$197.04	\$205.15	\$199.67	\$206.72	\$212.70
5-Area Steers	\$112.50	\$115.50	\$119.50	\$117.50	\$122.00	\$122.50
Year Ago	\$106.83	\$112.08	\$121.03	\$120.00	\$123.36	\$127.65

**Includes holiday-shortened weeks*

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