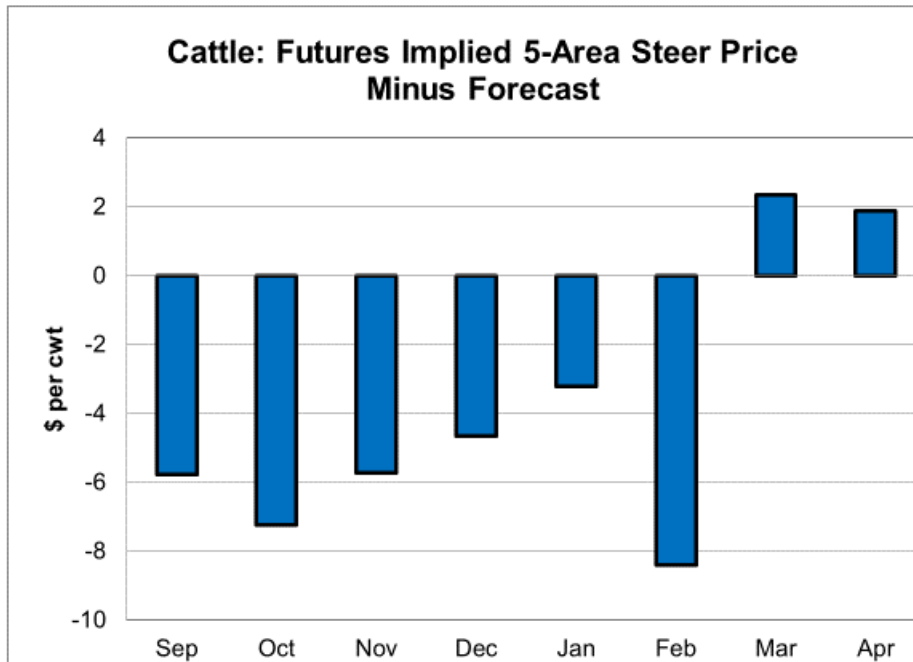


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

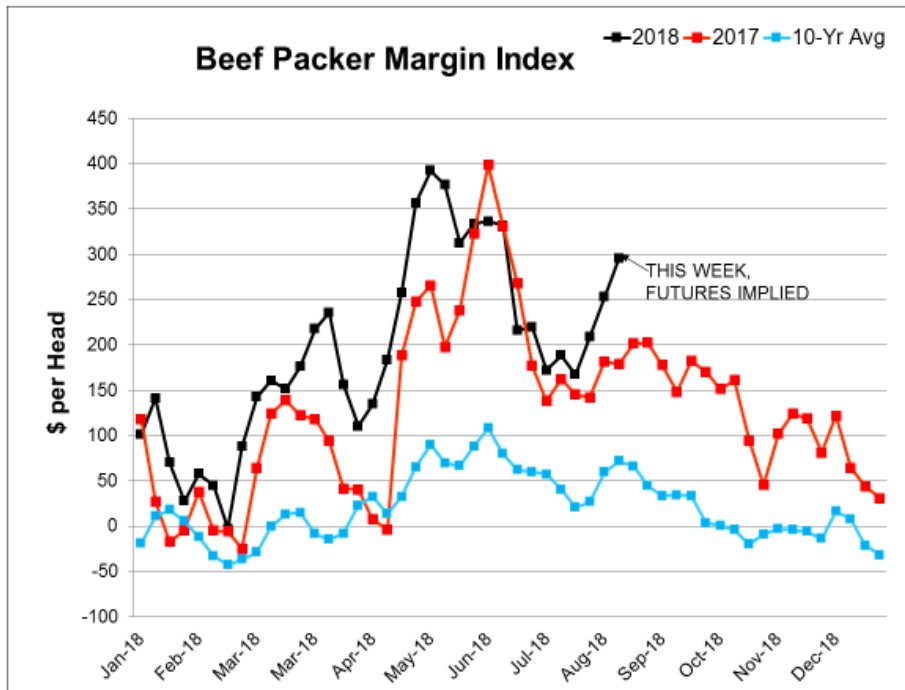
August 22, 2018



I am moving my very “seasoned” long position in the cattle market from the August to the October contract, provided that the latter can be bought at \$108.00. If I am unable to

do so, I will simply hold the August position through the end of the week. Thus, this is not exactly a “roll”, but two separate positions.

I am quite surprised that packer margins have ballooned as they did last week, and presumably—given the price action on the board this morning—again this week. The beef market is actually performing better than I had expected heading into Labor Day, but it appears that the futures market has allowed the cash cattle market to ignore this altogether. On the next page I show the weekly spot packer margin index, which the August contract is placing at a rather startling \$295 per head. Sure, it is seasonally normal for the margin to expand temporarily in this time frame....but not by *this* much. If it had remained where it was two weeks ago—which seemed to be a much more likely development, based on both recent and longer-term history—then this week’s cash cattle trade would be taking place at \$115.50. And so I am reminded once again that we are trading cattle prices and not beef prices.



I have to think that the situation of packer margins is temporary. The seasonal tendency for them to shrink in the weeks ahead is pretty consistent; and it makes sense that they *would* shrink again this time

around as front-end cattle supplies begin to tighten. My projection of an average packer margin index at \$175 per head in October is about \$30 wider than a year earlier, a greater year-to-year difference than we saw in June and July. But let's say that it slips back to "only" \$225, equal to the month-to-date average here in August—a very generous valuation, I think. In that case, the \$206 per cwt combined Choice/Select cutout value that I am forecasting in October would align with a Five Area Weighted Average Steer price of about \$111.50. The October futures contract would still be too cheap at this morning's trade levels.

I think it is reasonable, then, to treat this as a sideways trading range for the time being, bounded essentially by \$108.00 and \$112.00 in the October contract. A long-side bet at \$108.00 would carry a small risk, since a close-only stop at \$107.65 would be employed. A close below that level would open the gate to a move down to about \$105.50.

I am content to hold out for \$108.00 before placing a bet, mainly because the beef market is likely to trend downward from next week through the end of September. A typical seasonal change in wholesale beef demand, combined with an average weekly steer and heifer kill of 499,000 (holiday week included), would place the next low point in the combined cutout value at about \$202 per cwt at the end of September. [Yesterday's quote was \$211.71.] But I also consider that since the futures market has completely snubbed the recent increase in cutout values, it might look past the decrease as well. Still, I am always squeamish about being long of the board when the beef market is facing a significant setback.

Finally, then, how safe is the assumption that the combined cutout value will average \$206 in October? Starting with the simplest of all standards, a 0.6% decline from the apparent August average of \$207.25 would not be at all unusual; it would almost precisely match the ten-year average change from August to October. But it is also likely that the monthly wholesale beef demand index will be reaching its short-term cyclical peak in October, having established a cyclical low in July. At the least, this makes the prospect of a material “downdraft” in demand seem doubtful....even considering the intense competition from pork loin and butt prices.

Forecasts:

	Sep*	Oct	Nov*	Dec*	Jan*	Feb
Avg Weekly Cattle Sltr	631,000	636,000	628,000	604,000	616,000	611,000
Year Ago	624,400	629,500	625,700	593,800	595,400	594,200
Avg Weekly Steer & Heifer Sltr	499,000	498,000	490,000	474,000	481,000	480,000
Year Ago	502,100	500,900	498,600	472,600	466,400	465,800
Avg Weekly Cow Sltr	120,000	127,000	128,000	121,000	127,000	122,000
Year Ago	111,200	117,800	116,700	111,600	120,400	119,500
Steer Carcass Weights	895	901	903	899	891	884
Year Ago	896.0	897.8	902.6	902.8	892.8	884.0
Avg Weekly Beef Prodn	521	526	522	502	508	502
Year Ago	515.8	518.4	519.2	495.3	492.5	488.1
Avg Cutout Value	\$204.50	\$206.00	\$203.50	\$203.50	\$209.50	\$208.50
Year Ago	\$192.17	\$197.04	\$205.15	\$199.67	\$206.72	\$212.70
5-Area Steers	\$112.50	\$114.50	\$118.50	\$118.00	\$122.50	\$124.00
Year Ago	\$106.83	\$112.08	\$121.03	\$120.00	\$123.36	\$127.65

**Includes holiday-shortened weeks*

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