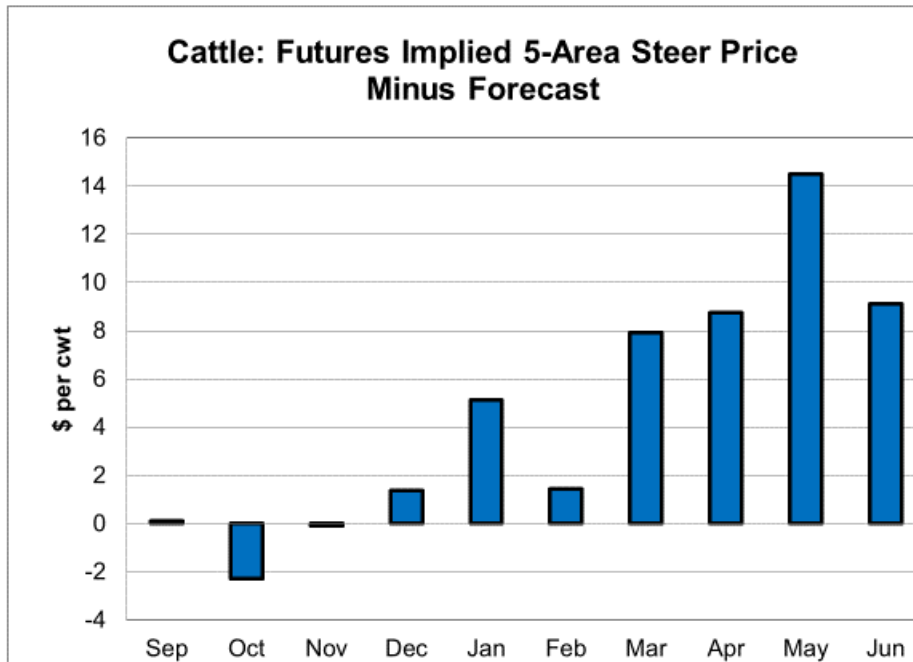


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

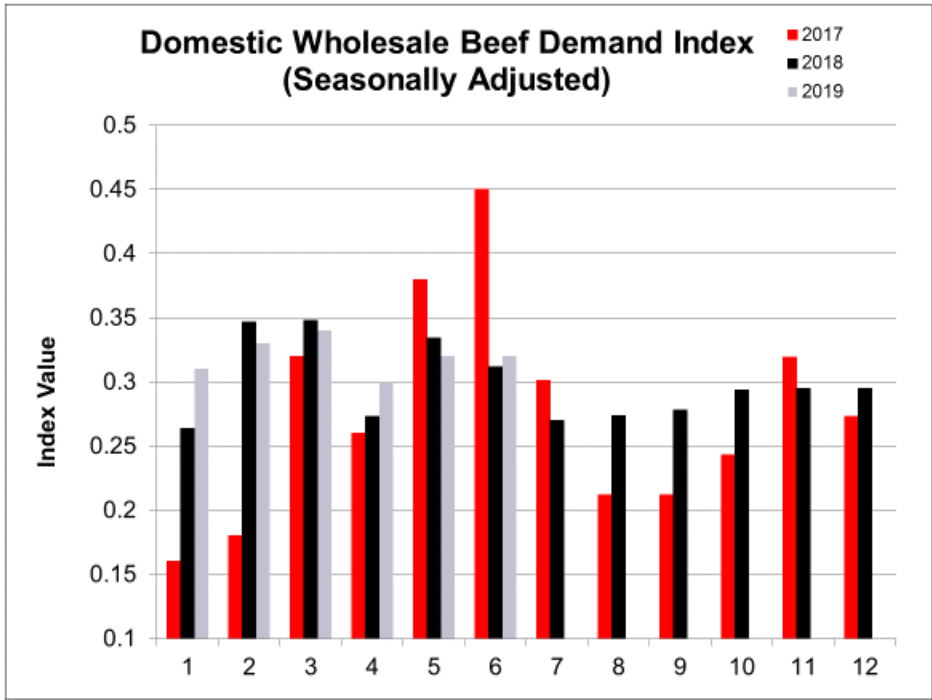
September 14, 2018



The picture to the left tells me that the bull spreads are worthy of a bet. In my last letter I said that I would buy October cattle and sell April at and April premium to \$10.50 per cwt, but I have not

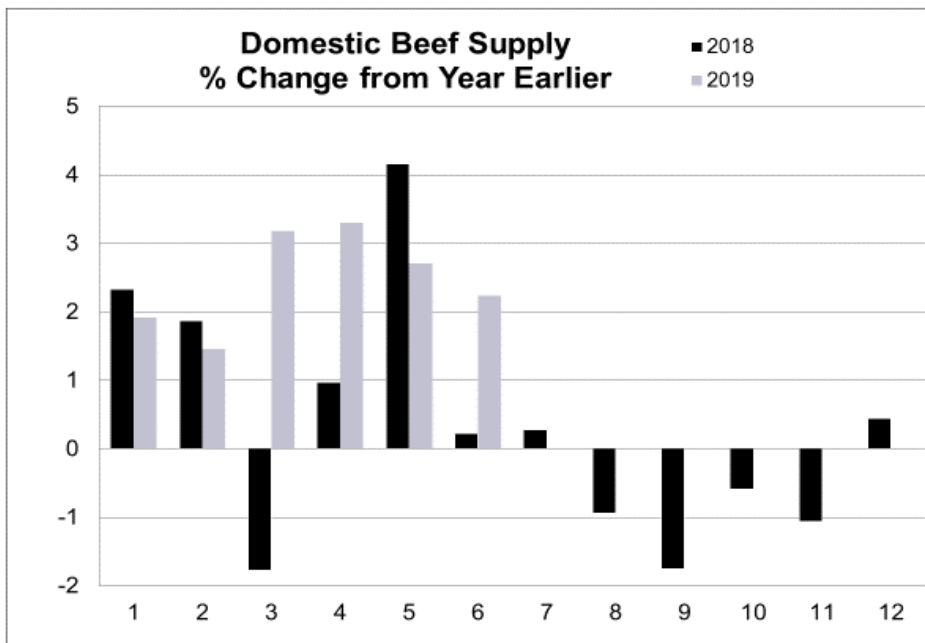
yet done so. My orders will go in at \$11.00 (or within a couple ticks of that price). I'm risking a missed opportunity by lowering my sights, but I can accept that. I halfway expect the April premium to punch into new highs for a day or two and then reverse. The livestock spreads have a history of behaving that way whenever they encroach upon "extreme" territory.

I am surprised by the optimism reflected in the April and June contracts. Naturally, it prompts me to wonder if I am overlooking something obvious. About the only thing I can think of that could cause these two options to be worth vastly more than my current assessment of "fair value" is a full-blown shortage of pork as a result of African Swine Fever. And yet, cattle futures appear to have already gone a long way toward discounting that scenario as well. In any case, if I am materially underestimating the ultimate value of April and June cattle, it would have to be because of something on the demand side of the equation. On the next page I show the projections of the seasonally adjusted demand index on which my forecasts are based.



I am assuming that “core level” demand in both April and June will exceed that of a year earlier, but there is always room for something better still. I would regard an index value

of .35 as pretty optimistic based on what we know right now. Yet, under that assumption I come up with a Five Area Weighted Average Steer price of \$121 in April; with the \$3.50-\$4.00 per cwt futures discount that has prevailed in each of the last two years during April, that would place the average settlement price in the April contract up to \$117.00-\$117.50. Currently it is situated above \$121.00. Likewise, under the more bullish demand scenario the cash cattle market in June would average about \$110.50 and the June futures settlements would average \$108.



The supply side of the equation next spring is decidedly bearish...in general, I mean. I am factoring in further growth of 1-2% in second quarter beef exports, and it still leaves net domestic beef

supplies 2-3% larger than a year earlier. An additional consideration is the potential squeeze on slaughter capacity during June. No one seems to be talking about it right now, but weekly steer and heifer kills could rather easily average 540,000 or more at that time. This past June, kills averaged 526,000 and spot packer margins averaged near \$325 per head.

It should not surprise you, then, that I am also placing a bet on the short side of June cattle here at \$114. I will add to this position at \$116.00 if the opportunity arises.

Forecasts:

	Sep*	Oct	Nov*	Dec*	Jan*	Feb
Avg Weekly Cattle Sltr	625,000	632,000	626,000	602,000	618,000	614,000
Year Ago	624,400	629,500	625,700	593,800	595,400	594,200
Avg Weekly Steer & Heifer Sltr	495,000	494,000	488,000	472,000	481,000	482,000
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	897	903	905	900	893	886
Year Ago	896.0	897.8	902.6	902.8	892.8	884.0
Avg Weekly Beef Prodn	515	522	519	499	509	504
Year Ago	515.8	518.4	519.2	495.3	492.5	488.1
Avg Cutout Value	\$203.50	\$205.50	\$203.00	\$203.00	\$211.00	\$208.00
Year Ago	\$192.17	\$197.04	\$205.15	\$199.67	\$206.72	\$212.70
5-Area Steers	\$109.50	\$113.50	\$115.50	\$115.50	\$118.50	\$118.00
Year Ago	\$106.83	\$112.08	\$121.03	\$120.00	\$123.36	\$127.65

**Includes holiday-shortened weeks*

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