

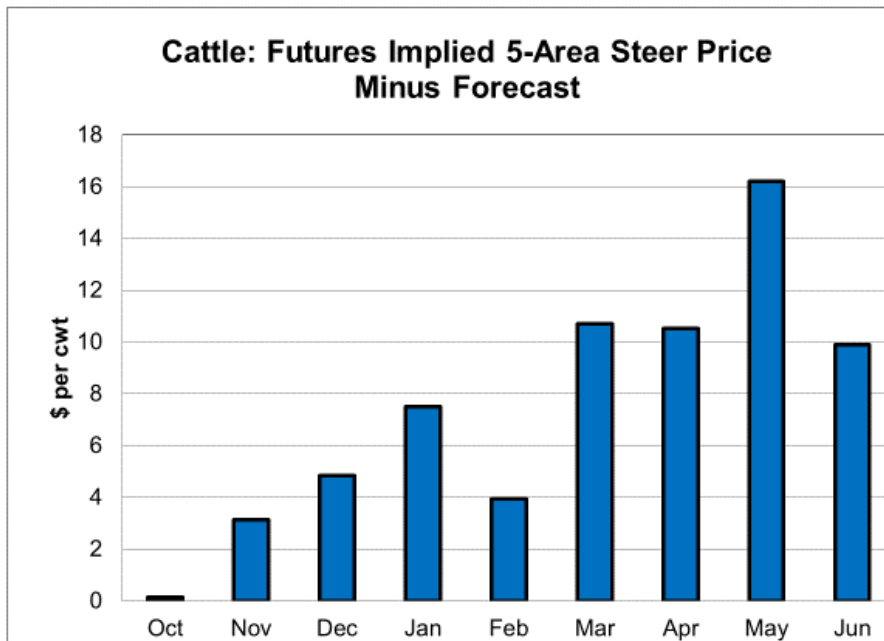
# Trading Cattle

## .... from a meat market perspective

A commentary by Kevin Bost

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September 21, 2018



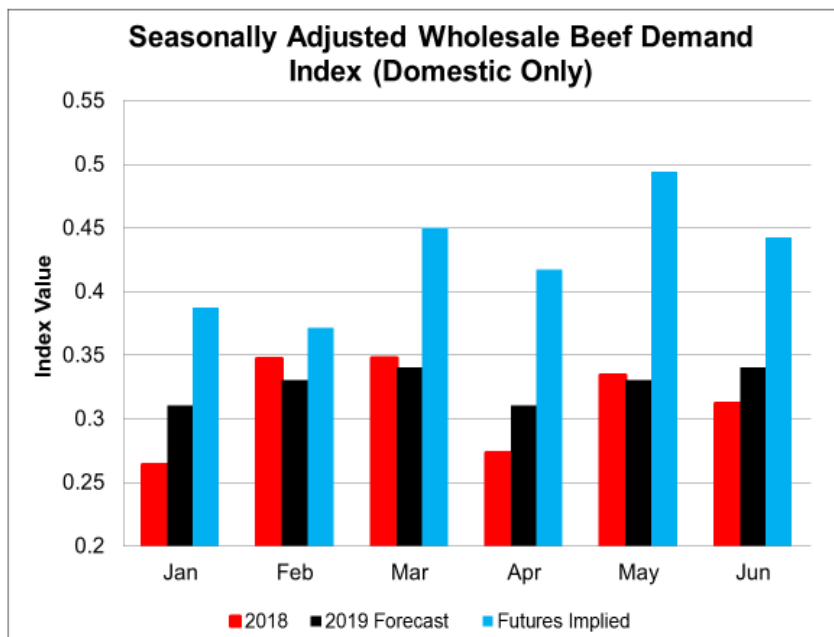
I am holding a moderate short position in the June contract, and intend to take on a long October / short April spread if it can be done at an \$11.00 per cwt April premium. That, of course, is the contract low of this

spread, established on July 11. It has been in an essentially sideways band since then, the upper boundary being an April premium of \$7.35. Actually, the contract low is \$10.97, so I am waiting to take advantage of a dip into new lows which, if it happens, should be very short-lived. If it doesn't happen, then so be it. I would be more aggressive toward this trade if I thought that the cash cattle market were about to launch into a big rally; instead, it seems more likely that it will work its way gradually up to \$115 and pull the October contract with it, while the April contract backs off from its recent high. My interest is piqued also by the fact that the April-over-October premium is nearly matching its all-time high for this time of year; the 15-year average in the third week of September is \$2.15....

....which brings me to the reason for the short-side bet in the June contract. Why is the board reflecting such optimism toward the springtime cattle market? I can think of only two possibilities. One is simply that the launch into new contract highs in all of the first-half 2019 options may have attracted a large amount fund buying. The other is that traders are anticipating a genuine shortage of pork (due to the African Swine Fever outbreak in China), and a massive shift in demand toward beef.

The technically-motivated fund buying makes perfect sense, and I will respect it with a close-only stop above \$116.50. But even if there is a lot more to come, there likely will be sizeable corrections along the way. If I am not stopped out, I plan to cover my positions on such breaks and re-establish them on rallies. I do not normally take this approach, but if June cattle are to reach my ultimate objective of \$106-something, it's not going to go there directly.

I can also appreciate the possibility that beef demand could be boosted by a shortage of pork. But by how much? In the picture below, I show the seasonally-adjusted wholesale demand index that I am factoring into my forecasts, along with the futures-implied index values as of this morning:



OK, it could be that my 2019 projections are a bit too conservative. But look at it this way: the year-to-date average index value is .300 vs. .275 a year ago; my projection for the first half of 2019 is .327. The point is that the futures market is discounting a very optimistic demand scenario.

It's not as if we're headed into a cyclical downturn in cattle supplies. Quite the opposite. After factoring in 5-6% year-over year increases in September and October placements, followed by unchanged to lower placements in November through February (they will be comparing with some relatively large year-earlier figures at that time), it looks as though steer and heifer kills will be running about 15,000 head per week above a year earlier in the first half of 2019, as I show in the picture on the next page. The supply outlook appears to be particularly menacing in May and June; whereas fed cattle slaughter averaged 526,000 per week in June 2018, it looks as though feedlot inventories will readily accommodate a rate of 540,000 or higher in June 2019. That will come dangerously close to practical slaughter capacity....

Forecasts:

	Sep*	Oct	Nov*	Dec*	Jan*	Feb
Avg Weekly Cattle Sltr	627,000	633,000	628,000	606,000	618,000	615,000
Year Ago	624,400	629,500	625,700	593,800	595,400	594,200
Avg Weekly Steer & Heifer Sltr	496,000	495,000	489,000	476,000	480,000	481,000
Year Ago	502,100	500,900	498,600	472,600	466,400	465,800
Avg Weekly Cow Sltr	121,000	128,000	129,000	122,000	129,000	125,000
Year Ago	111,200	117,800	116,700	111,600	120,400	119,500
Steer Carcass Weights	897	902	906	906	898	891
Year Ago	896.0	897.8	902.6	902.8	892.8	884.0
Avg Weekly Beef Prodn	516	523	521	506	512	508
Year Ago	515.8	518.4	519.2	495.3	492.5	488.1
Avg Cutout Value	\$204.00	\$205.00	\$202.50	\$201.00	\$210.00	\$207.00
Year Ago	\$192.17	\$197.04	\$205.15	\$199.67	\$206.72	\$212.70
5-Area Steers	\$110.50	\$113.00	\$115.00	\$114.00	\$118.00	\$117.50
Year Ago	\$106.83	\$112.08	\$121.03	\$120.00	\$123.36	\$127.65

*\*Includes holiday-shortened weeks*

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