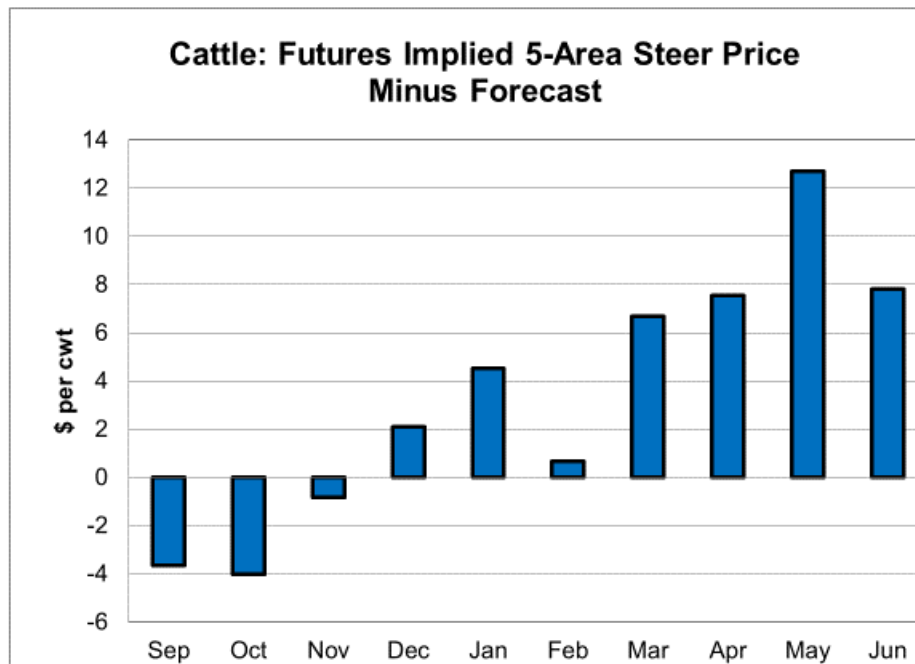


Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

September 6, 2018



I am interested in the long side of October cattle; the short side of the June contract; and the long October / short April spread. I'll address these in order.

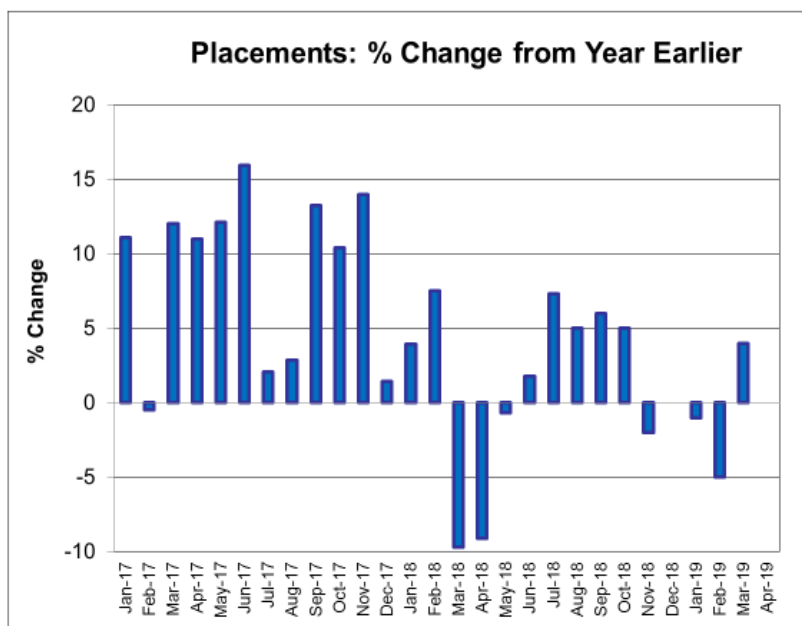
I am confident that the cash cattle market will move upward from here, mainly because the spread between cattle and beef prices is extremely wide and therefore likely to shrink. If I am semi-correct that the spot packer margin index will move from the current \$265 per head (or so) to \$180 by the end of the month, then it will be worth about \$6 per cwt to cattle prices. My honest-to-God best guess is that the combined Choice/Select cutout value will average near \$204.50 per cwt in October--\$2 lower than it was quoted this afternoon—which would place the Five Area Weighted Average Steer price at \$113. The forecast of a \$204.50 cutout value, by the way, would require little more than just a normal change in wholesale beef demand combined with an average weekly steer and heifer kill of 496,000 per week at that time. It is not a bold prediction.

I am still approaching this as a basically sideways market, though, bounded by \$105 on the lower end and \$112 on the upper end of the October contract. I plan to buy it as closely as possible to \$106.20 and again at about \$105.25, using a close-only stop below \$105.00. I notice that on Tuesday the October contract closed above the high of the outside range/reversal of August 27, and now has

closed back within that range; the textbooks say that this signals a test of the low end, which was \$106.20.

The long October/short April prospect I will treat as a separate position, although presumably it will perform better if the cash market moves higher in the near term. The parameters are readily apparent, as the contract low of a \$10.97 per cwt discount in the October contract provides a natural place for a stop. [Actually, it would require two closes below that level to kick me out of the trade.] I will try to enter this spread at \$10.50. The resistance levels are equally conspicuous at \$7.50 and again at \$7.00; my target would be in that range. In addition to the fundamental merit, the greatest premium that the April contract has carried against the October contract in the first week of October has been \$11.00, which occurred last year; over the past ten years, the average premium has been \$5.81.

Finally, the June contract appears to be vastly overvalued. Trading at \$112.50, it is pricing in an average cash cattle market of \$114.50-\$115.00. [In the past two years, settlements in the June contract averaged \$2.60 below the Five Area Weighted Average Steer price during the month of June.] True, a full-blown African Swine Fever epidemic *could* wind up justifying the premiums in the April and June cattle contracts; but most likely, it would take several months (at least) for a surge in demand for pork in China to have a tangible impact on the cash cattle and beef markets. In the meantime, a premium in the June contract will attract an increasing amount of hedge selling. June is a long way off in the distance, but if the pattern in placements looks anything like the projection I show below, then the beef supply in the second quarter of 2019 will become burdensome in relation to current futures price levels.



It's not being talked about much, but it's quite possible that the cattle supply will exceed practical slaughter capacity next June. It came close this past time around, with weekly kills averaging 654,000. My guess at the moment is that they will be around 675,000 in June 2019.

That rate of production, combined with exports that are up slightly from a year earlier and fairly stout demand would land the combined Choie/Select cutout value in the neighborhood of \$214 per cwt vs. \$217 a year earlier and a cash cattle market of about \$107 vs. \$110.39 a year earlier....unless slaughter capacity becomes an issue, in which case the cattle market would be lower. And so I will place a bet on the short side of the June contract at \$113.50, stopping myself out upon a single close above \$114.00. The short-term target would be \$111.00, and the eventual target would be \$107.50.

Forecasts:

	Sep*	Oct	Nov*	Dec*	Jan*	Feb
Avg Weekly Cattle Sltr	627,000	635,000	631,000	612,000	627,000	623,000
Year Ago	624,400	629,500	625,700	593,800	595,400	594,200
Avg Weekly Steer & Heifer Sltr	494,000	496,000	492,000	481,000	490,000	490,000
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	128,000	123,000
Year Ago	111,200	117,800	116,700	111,600	120,400	119,500
Steer Carcass Weights	898	904	906	902	894	887
Year Ago	896.0	897.8	902.6	902.8	892.8	884.0
Avg Weekly Beef Prodn	518	526	524	509	518	513
Year Ago	515.8	518.4	519.2	495.3	492.5	488.1
Avg Cutout Value	\$204.75	\$204.50	\$201.50	\$198.50	\$208.00	\$205.50
Year Ago	\$192.17	\$197.04	\$205.15	\$199.67	\$206.72	\$212.70
5-Area Steers	\$111.50	\$113.00	\$114.50	\$112.50	\$116.50	\$116.50
Year Ago	\$106.83	\$112.08	\$121.03	\$120.00	\$123.36	\$127.65

**Includes holiday-shortened weeks*

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