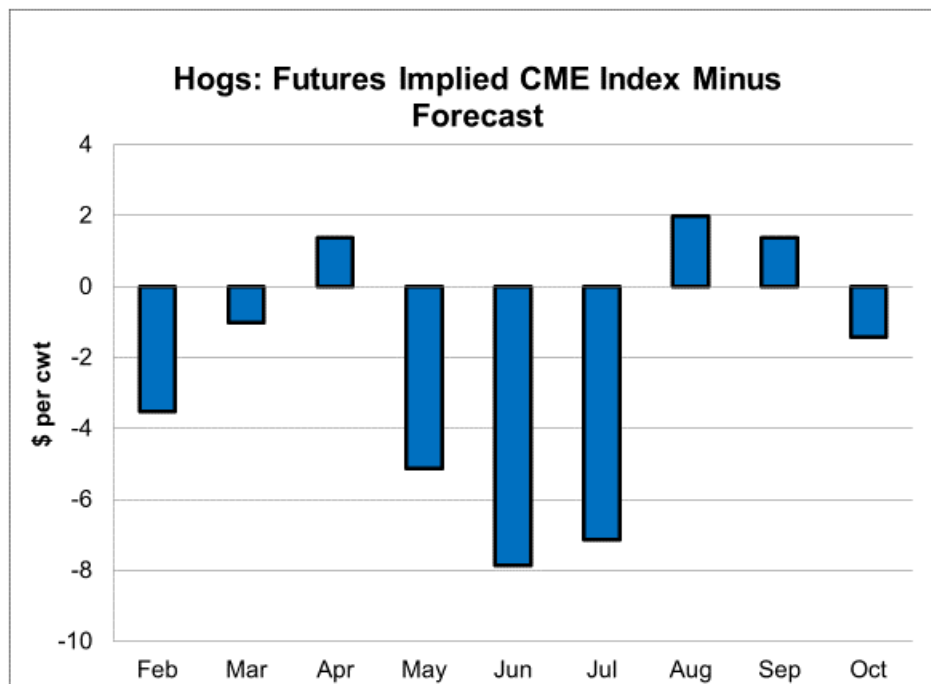


Trading Hogs

.... from a meat market perspective

A commentary by Kevin Bost

January 21, 2019



I retain the long position in February hogs that was initiated about three weeks ago, and I added a short position in the April contract on Friday. Before I go any further,

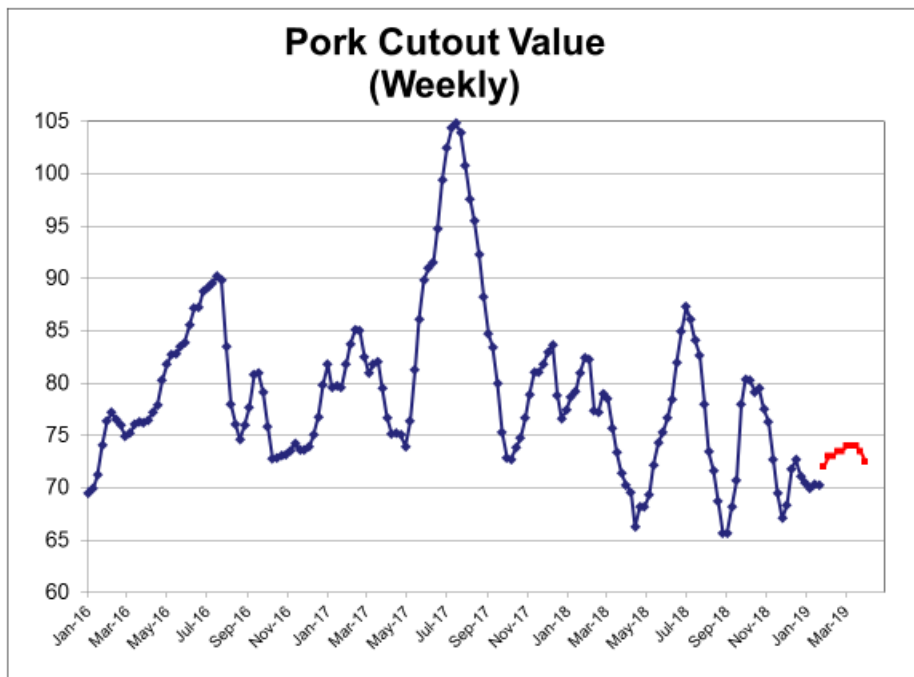
let me explain that these are two separate plays and will be managed accordingly. I am maintaining a sell stop in the February contract and a buy stop in the April, and will ignore whatever the spread might be doing in the meantime.

I placed a short-side bet in the April contract because the chart looks overwhelmingly bearish. It's as simple as that. The drop below \$65.40, an obvious support level that has held the market up since last *August*, completes a massive top formation with the substance to generate a major leg downward. I will risk this trade up to a close above \$68.00.

Rarely do I sell a market that does not appear to be substantially overvalued from a fundamental standpoint, or buy a market that is not undervalued. If you have been reading my letters for very long, you know this already. I am willing to suspend this rule *only* when the technical signal is overpowering. This one qualifies.

The most objective forecast I can come up with at this point tells me that the ultimate value of the April futures contract lies near \$65 per cwt. Could April hogs trade down to \$60, even if they are actually worth \$65? Of course. But what if China does not start importing a lot of U.S. pork before mid-April? What if U.S. pork exports to China/Hong Kong/Taiwan during April are the same as a year earlier, and domestic demand merely makes normal seasonal changes between now and then? In that case, the CME Lean Hog Index would average only \$62.50-\$63.00 in April. Though improbable, these are not far-fetched conditions.

As for the long February position, neither the cutout value nor the CME Lean Hog Index performed as thought they would this past week. Examining a little more closely, pork bellies were mainly responsible for the “failure to launch”. It stands to reason that if the bellies hold their ground, the cutout value will advance. As I outlined in *Meat Markets under a Microscope*, it appears that belly prices have simply “reset” after gaining a little too much, a little too fast, and are not heading into a tailspin. Still, I have tamed my forecast of the cutout value, lowering it to about \$73.50 per cwt in mid-February. That’s not asking much:



Otherwise, the other major variables in the pricing equation are behaving pretty much as expected. Most importantly, packer margins narrowed another \$2 per cwt, averaging

\$16.76 this past week. I am counting on a drop down to \$13 over the next four weeks, which would still leave it \$4 wider than a year earlier at that time. A \$73.50 cutout value combined with a gross packer margin of \$13 would place the CME Index just above \$65. I remind myself that there remains a gap on the daily chart at \$64.45.

Meanwhile, hog slaughter is tracking fairly well with USDA's summer pig crop estimate. It dropped 48,000 head this past week to 2,508,000, and it should fall another 60,000 by the first week of February.

In view of last week's price action on the board, I cannot identify a meaningful place for a stop-loss above \$58.77. And so there it shall be, on a closing basis. If that support level were to give way this late in the game, it would clearly indicate that my cash price forecast is fatally flawed.

Forecasts:

	Feb	Mar	Apr	May*	Jun	Jul*
Avg Weekly Hog Sltr	2,448,000	2,453,000	2,403,000	2,321,000	2,284,000	2,244,000
Year Ago	2,396,090	2,403,610	2,370,400	2,258,700	2,220,400	2,160,700
Avg Weekly Barrow & Gilt Sltr	2,380,000	2,385,000	2,335,000	2,255,000	2,215,000	2,180,000
Year Ago	2,330,170	2,338,350	2,304,900	2,195,200	2,154,700	2,099,000
Avg Weekly Sow Sltr	61,000	61,000	61,000	59,000	61,000	57,000
Year Ago	58,640	58,540	58,500	56,600	58,400	54,700
Cutout Value	\$73.50	\$73.50	\$76.00	\$85.00	\$92.00	\$93.50
Year Ago	\$78.04	\$72.71	\$68.08	\$73.59	\$83.18	\$82.70
CME Lean Hog Index	\$64.75	\$64.50	\$65.00	\$77.00	\$87.00	\$88.00
Year Ago	\$71.61	\$63.51	\$56.47	\$66.77	\$81.13	\$78.73

**Slaughter projections include holiday-shortened weeks*

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