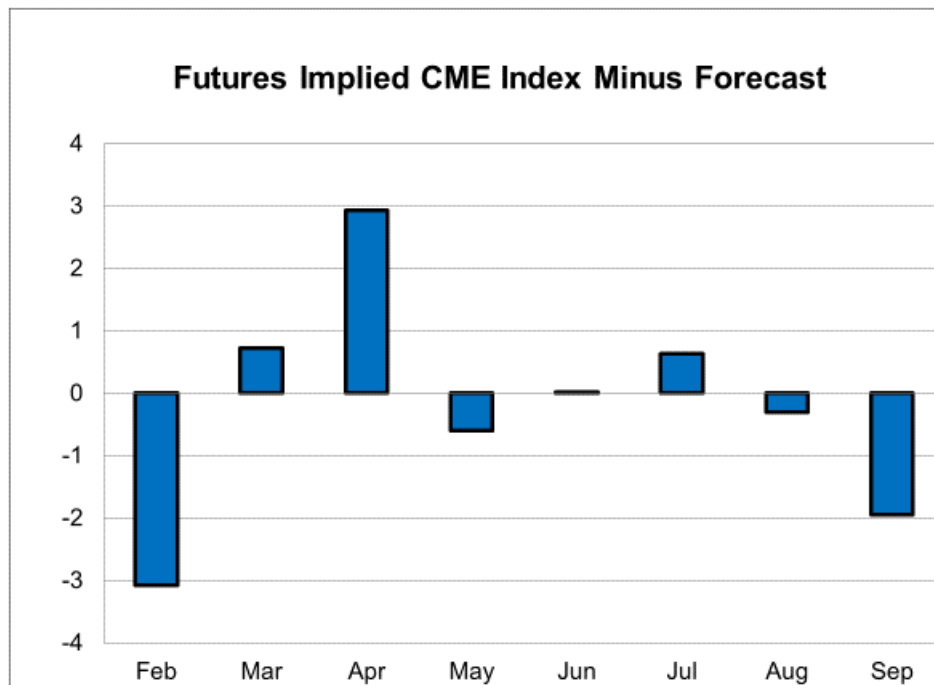


Trading Hogs

.... from a meat market perspective

A commentary by Kevin Bost

January 23, 2018

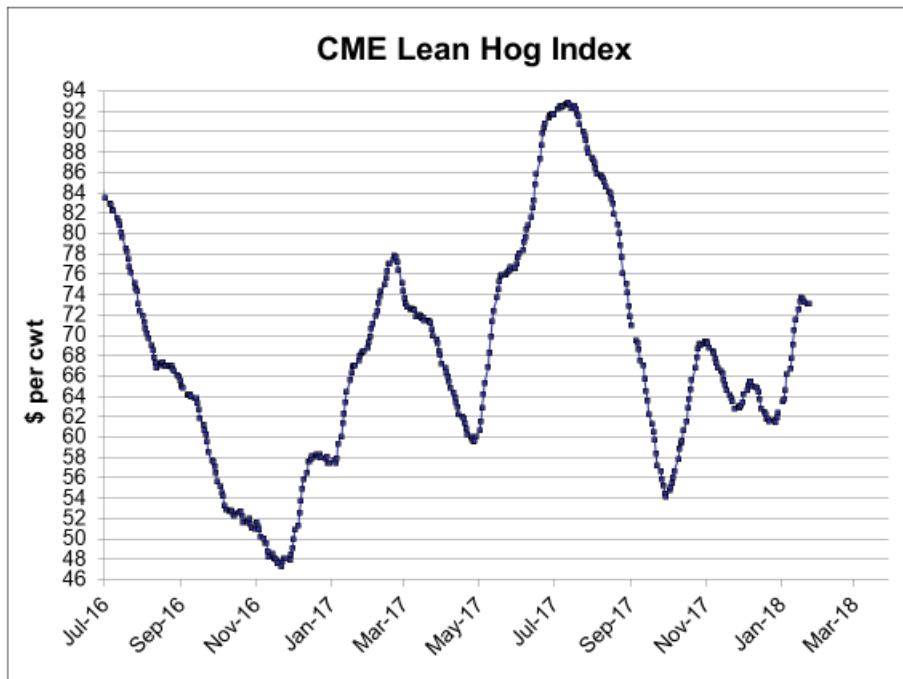


I am holding two positions in the hog market this morning: I am minimally short of the February \$71 puts, and I am still long of the February/April spread.

I seem to have a lot of company in the bull spread, which is a bit disconcerting. But the

fundamental foundation of this trade remains solid. Of course, both contracts could go off the board precisely where I am forecasting--\$75.00 in February, \$71.50 in April—and yet the spread may not work in my favor prior to February 14. So it goes sometimes. And so I turn to the chart, which has given back some ground in the last several days but which remains in an uptrend. When would that uptrend be negated? If the discount in the February contract were to widen back out to something beyond \$3.80 per cwt—the “breakout point”—then the trend would be neutralized. It is too late in the game for this to be happening if the two contracts are to draw even with each other, as I am hoping.

The CME Lean Hog Index has sputtered a bit in the last few days (my estimate of the single-day value for today's kill is \$73.15 per cwt), but it seems likely to have another couple of dollars left “in the tank” before it establishes an interim peak. I am counting on a slight, further tightening of the packer margin to make this happen. The quoted gross margin averaged \$12.78 per cwt last week, and I am guessing that it will average \$12 in February. That would compare with \$15.27 in February 2017. It is a reasonable expectation, I think, given the strong tendency for margins to narrow between the third week of January and the middle of February; and considering that as far as I know, both of the new packing plants will have expanded their production schedules by February.



The pork cutout value, meanwhile, will not make any major move until the pork bellies dictate. That move should be downward, but perhaps not until prices reach \$1.50 per pound—about 7¢ above yesterday's quote. Since that price level precipitated a

slowdown in wholesale bacon demand (from the supermarket sector, mainly) in December, then why would it not do so again just one to two months later? A sizeable setback in belly prices seems to be in order in late winter/early spring, which is a primary reason why I look for the cutout value to be somewhat lower in March and April than it is today. Another reason is because the ham market—which appears to be nearing a top—should go through its normal deflationary period once Easter business is completed. I will have more than just the passing interest in tomorrow's *Cold Storage* report, as we will find out how much the frozen belly reserve grew in December. My guess is that it increased by five to ten million pounds, which would post the January 1 stock 23-28 million pounds above a year ago.

If my forecast of a \$71-\$72 CME Index in April is not way off the mark, then there is a short-side trading opportunity in the April contract. Not all lights are flashing "green" for this trade, however, because at this point it appears that an outright short position would have to be risked all the way up to the contract high....placing the risk: reward proposition "out of bounds" at the moment.

Forecasts:

	Jan*	Feb	Mar	Apr	May*	Jun
Avg Weekly Hog Sltr	2,394,000	2,377,000	2,373,000	2,362,000	2,323,000	2,278,000
Year Ago	2,361,900	2,327,100	2,326,700	2,285,400	2,250,200	2,183,400
Avg Weekly Barrow & Gilt Sltr	2,327,000	2,310,000	2,305,000	2,295,000	2,255,000	2,210,000
Year Ago	2,297,700	2,262,400	2,260,900	2,220,200	2,185,200	2,117,200
Avg Weekly Sow Sltr	61,000	60,000	61,000	60,000	61,000	61,000
Year Ago	59,900	58,400	58,900	58,100	57,900	58,800

Cutout Value	\$80.50	\$81.50	\$79.00	\$79.00	\$84.50	\$89.50
Year Ago	\$80.18	\$84.08	\$80.20	\$74.86	\$84.92	\$97.04
CME Lean Hog Index	\$71.00	\$74.50	\$72.50	\$71.50	\$80.00	\$84.00
Year Ago	\$63.80	\$74.16	\$71.50	\$62.60	\$72.28	\$86.09

**Slaughter projections exclude holiday-shortened weeks*

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