

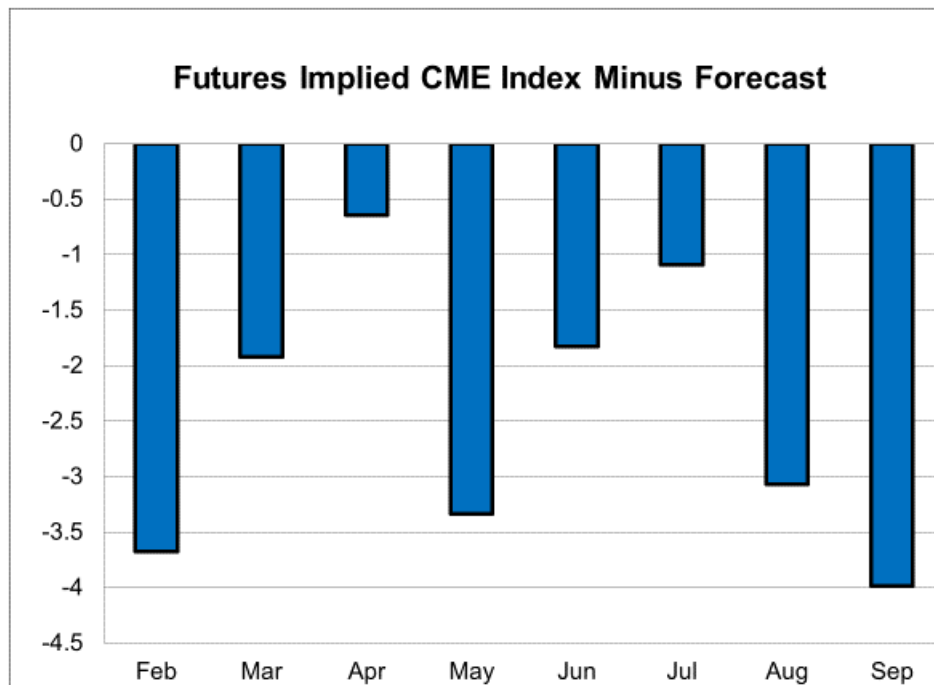
# Trading Hogs

## .... from a meat market perspective

A commentary by Kevin Bost

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January 30, 2018



I continue to hold a moderate long position in the February / April spread, and a minimal short position in the February \$71 puts. The market is not giving me a reason to get out of either just yet. The CME Lean Hog Index has certainly flattened out over the last

six trading days, but a pretty good case can be made for a \$76 Index value on the expiration date of the February contract (February 14). Such an outcome would, of course, cause the \$71 puts to become worthless, and would also increase the likelihood that the February contract will maintain a premium over the April contract. It might be worth noting that in the second week of February 2017, the February contract moved to a premium of \$1.77 per cwt (on a weekly average basis); and in 2013 it widened to \$1.98.

So, then, what's the case for another "mini leg up" in the CME Index between now and mid-February? Quite simply, it is the realistic possibility that the pork cutout value will gain ground slightly while packer margins tighten a bit further.

Regarding the cutout value, it does seem that a further advance will face a "headwind". This will be possible only if the belly market hold its ground (or continues to notch upward) for another couple of weeks before it begins a retracement. The same goes for hams. Meanwhile, bone-in loins, spareribs, and fat trimmings could easily contribute to the cause. The seasonal track record of the cutout value shows an upward bias between now and the second week of February, having increased or held steady in ten of the last 15 years. As for the spot packer margin, the historical case is not so compelling; but it *has* tightened in four of the past five years over the same time frame. As far as I know, the new plants in Coldwater and Sioux City are still planning

to expand to a full, single shift in February. Last week's gross packer margins averaged \$13.75 per cwt; a \$76 CME Index would require only a combination of a \$12 gross margin and an \$83 cutout value (yesterday's quote was \$82.81).

I am anticipating a major peak in the cash hog market that should hold up for approximately three months. And so, even though the picture on the first page suggests that I should be looking for a trading opportunity from the long side of the market, my intuition tells me otherwise. From a fundamental standpoint, a proper entry point from the short side—one which proposes an acceptable risk: reward ratio—is pretty far away. If I can believe my own work, then the April contract is ultimately worth about \$72 per cwt, about where it trades this morning. This assessment assumes an average weekly kill of 2,360,000 in April; a *slightly* weaker-than-normal change in wholesale pork demand from January to April; and a gross packer margin of \$12 per cwt (vs. \$17.61 a year earlier). If I were to place full faith in these projections, then I could not bet on the short side of the April contract anywhere below \$74.00.... and even that would be a stretch. At this point, it appears that a short position would have to be risked up to last Thursday's high of \$76.52. The market may never get that high again, but that is a possibility I can live with.

Forecasts:

	Feb	Mar	Apr	May*	Jun	Jul*
Avg Weekly Hog Sltr	2,357,000	2,363,000	2,362,000	2,323,000	2,278,000	2,291,000
Year Ago	2,327,100	2,326,700	2,285,400	2,250,200	2,183,400	2,211,300
Avg Weekly Barrow & Gilt Sltr	2,290,000	2,295,000	2,295,000	2,255,000	2,210,000	2,225,000
Year Ago	2,262,400	2,260,900	2,220,200	2,185,200	2,117,200	2,149,300
Avg Weekly Sow Sltr	60,000	61,000	60,000	61,000	61,000	59,000
Year Ago	58,400	58,900	58,100	57,900	58,800	55,000
Cutout Value	\$82.50	\$80.00	\$80.00	\$85.50	\$90.00	\$89.50
Year Ago	\$84.08	\$80.20	\$74.86	\$84.92	\$97.04	\$103.48
CME Lean Hog Index	\$75.50	\$73.50	\$73.00	\$81.00	\$84.50	\$84.00
Year Ago	\$74.16	\$71.50	\$62.60	\$72.28	\$86.09	\$91.47

*\*Slaughter projections exclude holiday-shortened weeks*

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