

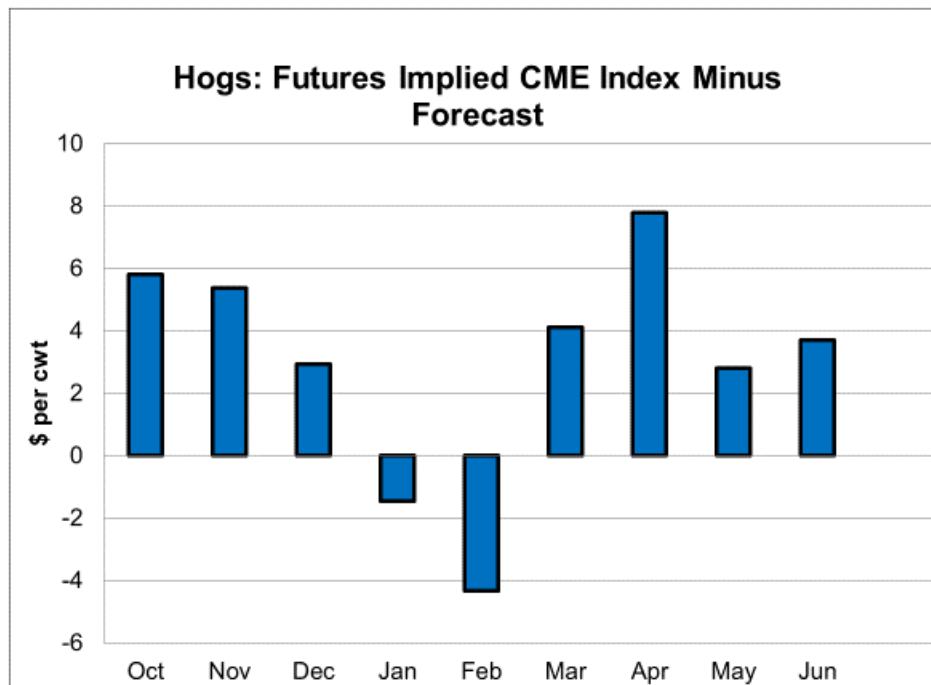
# Trading Hogs

## .... from a meat market perspective

A commentary by Kevin Bost

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October 1, 2018



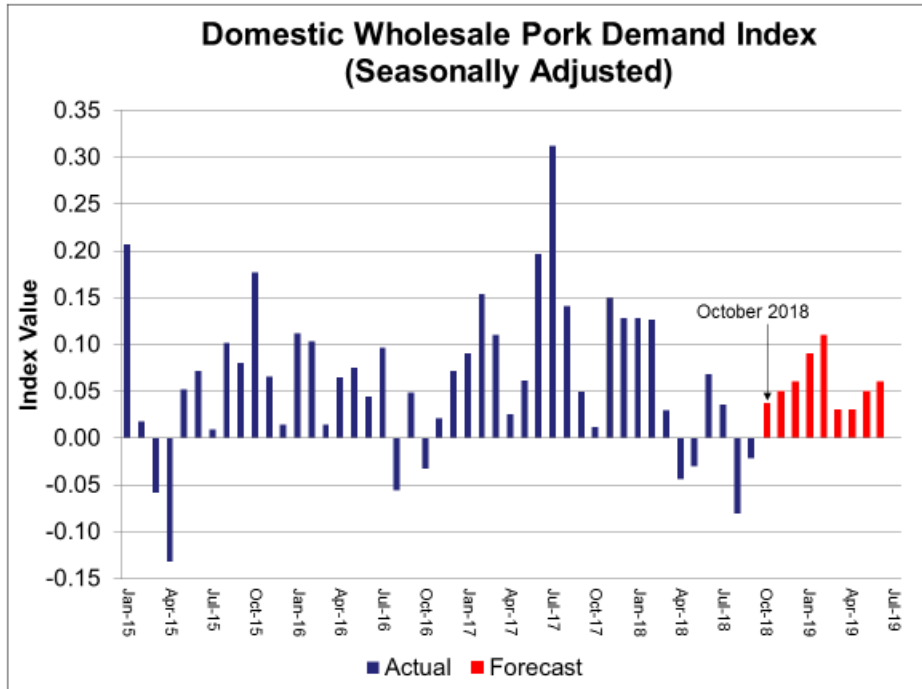
My attention remains on the short-side opportunity in the December contract and the short December / long February spread, although neither is in my portfolio at the moment. I do not intend to place a bet in both, since I view the spread as a less risky mutation of

the outright short position. And so I will take on whichever opportunity presents itself first—selling December hogs in the neighborhood of \$60.50, or selling December/buying February at a February premium of \$6.50 per cwt. In the case of the former, I would be willing to risk about 100 points vs. a profit potential of about 650 points; in the case of the latter, the risk would amount to roughly 50 points and the profit target would be about 300.

One way or the other, the most compelling reason to approach the nearby market from the short side is the likelihood of a steep drop in the cash hog market over the next 30 days. I am assuming, of course, that both the cutout value and the CME Lean Hog Index have “overshot the mark” over the course of their respective \$16 and \$23 per cwt gains since late August. In other words, both are situated far above the price levels that can be sustained with hog slaughter running consistently near 2,585,000 in October and 2,650,000 in November.

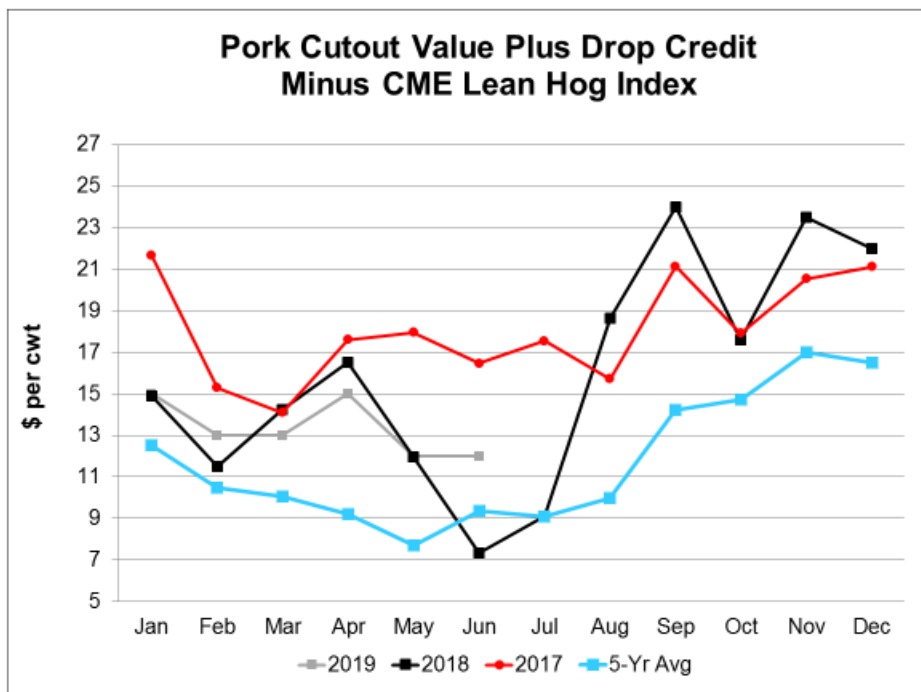
The ability of the market to absorb that rate of production naturally depends on pork demand. This is always a moving target, but I think my assumptions are pretty reasonable. I show my projections of the seasonally adjusted demand index on the next page. My guess is that wholesale demand will return to more “normal” levels in the fourth quarter, following dismal readings in August and, to a lesser extent, September. Why not? The recent rally in pork prices has not (so far, anyway) not lasted long enough to impact demand for any appreciable length of

time. Meanwhile, retail pork prices are trending downward, which should boost demand at the wholesale level.



Paying attention to the more bullish possibilities is the priority, though, since I am entertaining a short-side bet. OK, so if I substitute an index value of .12 those shown in the graph for October-December, then the equation yields average

cutout values of \$80 per cwt in October and \$76 in both November and December. Quite a difference from the forecasts shown in the table below, but if my projections of gross packer margins (shown in the next picture are in the right ballpark, then the higher cutout values would result in average CME Index values of \$64 in October; \$58 in November; and \$60 in December.



These rather extreme possibilities would render the December contract fairly priced at my entry target of \$60.50, but they would still mandate a drop of roughly \$10 per cwt from today's CME Index value. I would think that this would offer a decent profit

opportunity in the short run....which is why I listed the likelihood of a sharp drop in cash hog prices as the primary attraction to a short-side bet in the first place.

Forecasts:

|                               | Oct       | Nov*      | Dec*      | Jan*      | Feb       | Mar       |
|-------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Avg Weekly Hog Sltr           | 2,591,000 | 2,572,000 | 2,477,000 | 2,463,000 | 2,448,000 | 2,458,000 |
| Year Ago                      | 2,503,700 | 2,422,100 | 2,420,500 | 2,339,270 | 2,396,090 | 2,403,610 |
| Avg Weekly Barrow & Gilt Sltr | 2,525,000 | 2,505,000 | 2,410,000 | 2,395,000 | 2,380,000 | 2,390,000 |
| Year Ago                      | 2,436,800 | 2,357,600 | 2,356,000 | 2,273,500 | 2,330,170 | 2,338,350 |
| Avg Weekly Sow Sltr           | 58,000    | 59,000    | 59,000    | 60,000    | 61,000    | 61,000    |
| Year Ago                      | 59,300    | 57,300    | 56,800    | 57,620    | 58,640    | 58,540    |
| Cutout Value                  | \$74.00   | \$71.00   | \$72.00   | \$75.00   | \$77.50   | \$72.50   |
| Year Ago                      | \$74.51   | \$81.18   | \$79.14   | \$80.74   | \$78.04   | \$72.71   |
| CME Lean Hog Index            | \$61.00   | \$52.50   | \$55.00   | \$64.75   | \$69.00   | \$64.50   |
| Year Ago                      | \$61.73   | \$65.88   | \$63.28   | \$70.97   | \$71.61   | \$63.51   |

*\*Slaughter projections include holiday-shortened weeks*

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