

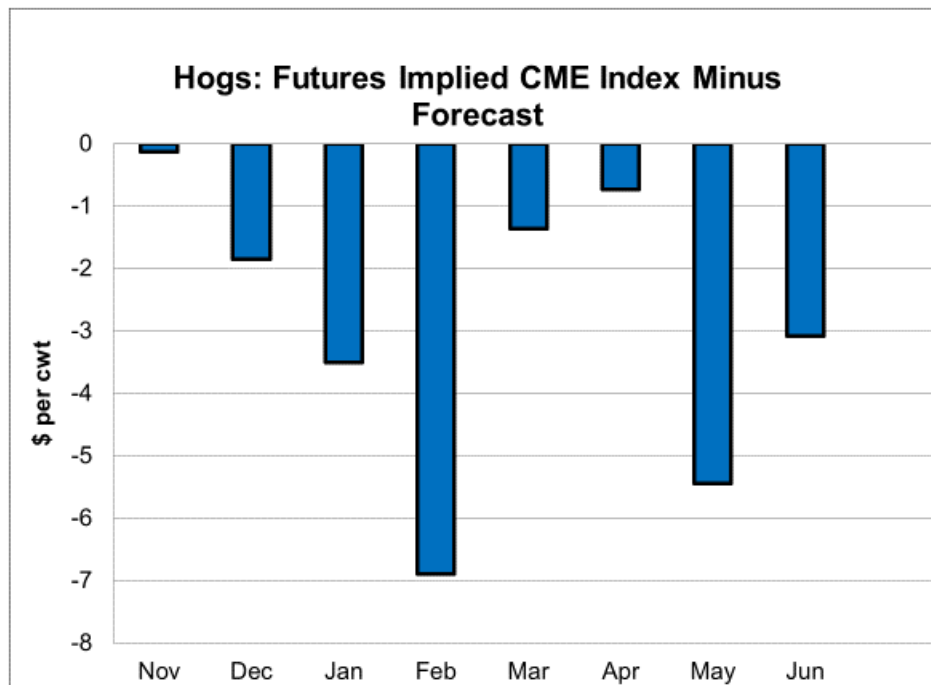
# Trading Hogs

## .... from a meat market perspective

A commentary by Kevin Bost

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October 17, 2018



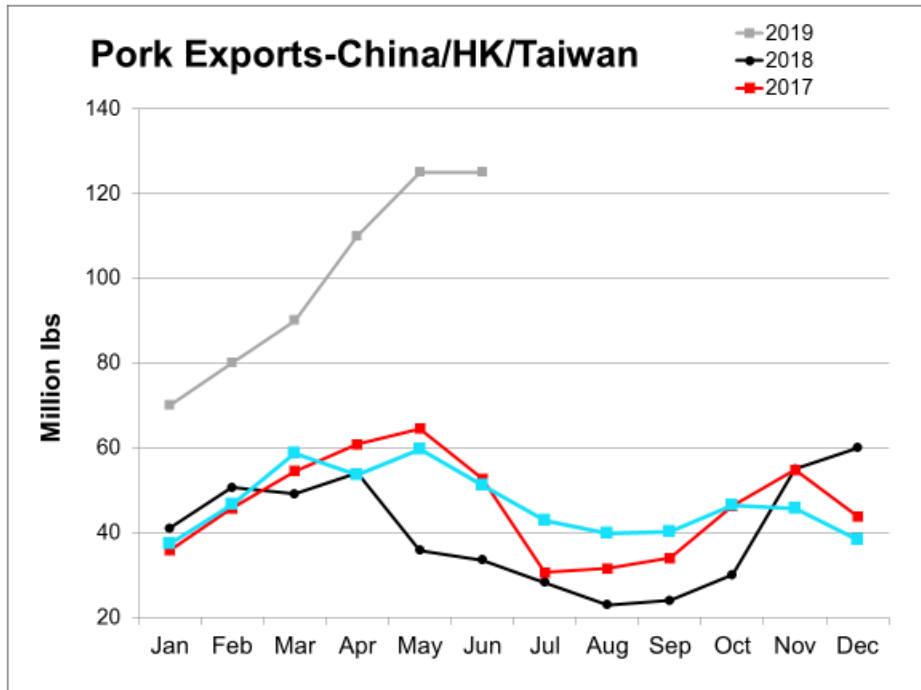
When I adopt the assumption that there will be a leap in U.S. pork exports to China in the months ahead, I am inclined to approach the hog market from the long side—especially in the February contract. But before I get too excited about placing a bet, I have to remind

myself that the notion of a steep increase in exports is rather bold, let alone the degree to which they may expand. The projections shown on the next page mirror the pattern in Chinese imports of U.S. pork that unfolded in 2007-2008, the last time that a swine disease severely reduced Chinese pork production.

My revised price forecasts also take into account the likely increase in demand for pork at the wholesale level that would attend a shift from year-over-year surpluses to deficits in net domestic pork supplies; and the widening of packer margins that would probably be associated with stronger cutout values.

There are lots of caveats, even more than usual. But there is a greater than 50/50 chance that African Swine Fever will become as serious as did the “Blue Ear” virus on 2007-2008....isn't there? I just have to proceed cautiously, that's all.

And in the meantime, the futures market will endure a round of persistently lower cash prices. Hog slaughter, which itself has recently become unusually difficult to explain and project, should take a major step upward very soon. Over the five non-holiday weeks since Labor Day, it has averaged 2.5% below a year earlier. Even if it does average 2,600,000 through the balance of October; 2,572,000 in November (including the holiday); and 2,477,000 in December (again,



including the holiday); then the fourth quarter kill will still be up “only” 3.5% from a year ago, whereas the spring pig crop was estimated to be up 4.3%. Naturally, this will place heavy pressure on the cutout value. The downward pressure on hog prices should be even more

intense, as packer margins likely will widen considerably. My assumption is that they will return to where they stood in the middle of September. And, even though the February contract carries a \$4 per cwt discount to the CME Lean Hog Index—the fourth largest since 2003—at this point, we really don’t know how far the Index can drop before it hits bottom. The decline has just begun.

I may be dreaming, but the daily chart of February hogs shows a gap at \$56.57 which just *might* be filled before it’s all over. There are two big support levels at \$62.00 and about \$59.50, but nothing between \$59.50 and \$56.57. Since my Honest-to-God best guess is that the CME Index will average around \$53.50 in November, the notion that February futures could trade down to \$56.57 does not seem all that far-fetched.

There are other strategies worth considering. One is a purchase of February calls. However, I cannot find anything on the options menu that interests me much, because they are expensive; the \$70 calls (which is about what I think the February contract is worth) would cost \$2 per cwt right now.

The other is a long February/short April spread, which has fundamental merit by virtue of the picture on the first page. Also, the contract low in this spread is \$-7.15 (i.e., an April premium of \$7.15), and the lowest it has ever averaged in November since the carcass weight-based futures contract came into existence is \$-7.31, in 2008. I will probably place a bet on this one if I can get it done at \$-7.00....and I definitely will, if the spread takes out its contract low and then curls immediately back upward.

Forecasts:

	Nov*	Dec*	Jan*	Feb	Mar	Apr
Avg Weekly Hog Sltr	2,572,000	2,477,000	2,463,000	2,448,000	2,458,000	2,418,000
Year Ago	2,422,100	2,420,500	2,339,270	2,396,090	2,403,610	2,370,400
Avg Weekly Barrow & Gilt Sltr	2,505,000	2,410,000	2,395,000	2,380,000	2,390,000	2,350,000
Year Ago	2,357,600	2,356,000	2,273,500	2,330,170	2,338,350	2,304,900
Avg Weekly Sow Sltr	59,000	59,000	60,000	61,000	61,000	61,000
Year Ago	57,300	56,800	57,620	58,640	58,540	58,500
Cutout Value	\$72.00	\$74.00	\$76.50	\$79.00	\$79.00	\$81.50
Year Ago	\$81.18	\$79.14	\$80.74	\$78.04	\$72.71	\$68.08
CME Lean Hog Index	\$53.50	\$57.00	\$64.50	\$70.00	\$70.00	\$69.50
Year Ago	\$65.88	\$63.28	\$70.97	\$71.61	\$63.51	\$56.47

*\*Slaughter projections include holiday-shortened weeks*

Trading Hogs is published weekly by Procurement Strategies Inc., 99 Gromer Road, Elgin IL 60120. For subscription information, please contact Kevin Bost at (847) 212-7523 or Kevin\_Bost@comcast.net; or visit our website at [www.procurementstrategiesinc.com](http://www.procurementstrategiesinc.com).

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