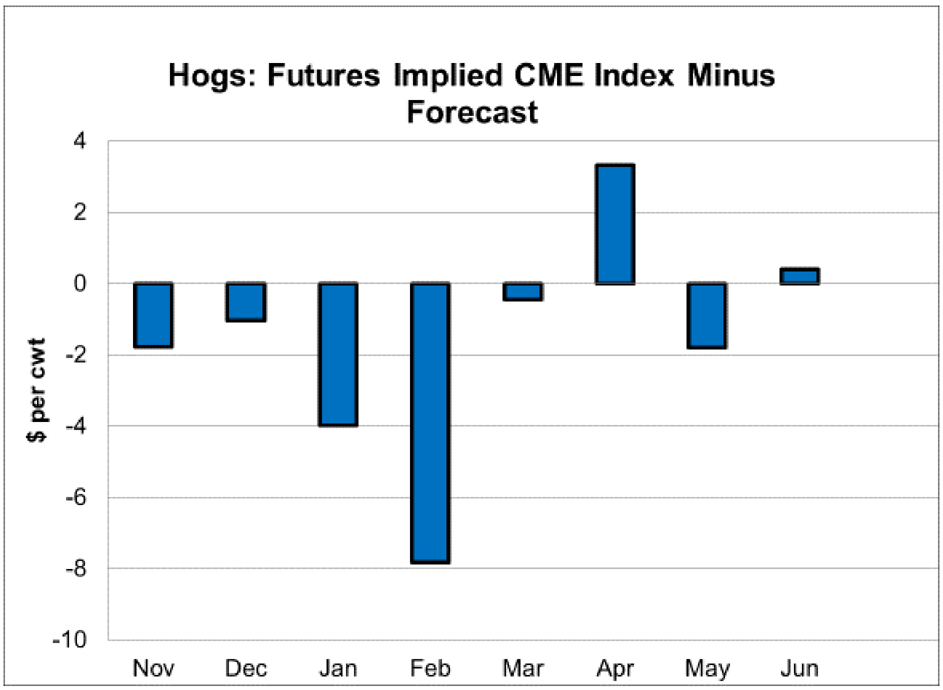
Trading Hogs
…. from a meat market perspective
A commentary by Kevin Bost

November 11, 2018

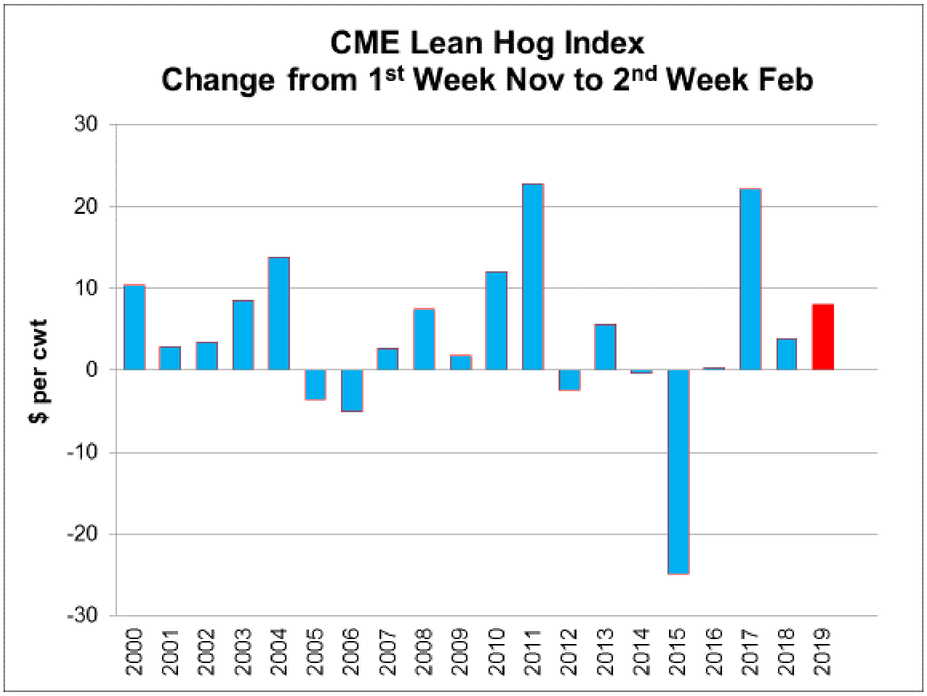


I am planning to buy February hogs outrigt, but I first want to see the gap on the daily chart at 56.57 filled. It is not far away, especially considering that the cash markets are weaker than I had anticipated. My guess is that the CME Lean Hog Index will lose another $6-$7 per cwt. Actually, the nearest major support level below $57.00 lies at $54.67, and this is approximately where my buy orders will be placed until the market tells me that it will not get there.

I remind myself that all the reasons why I have been so cautious about betting my money in the hog market are still intact….perhaps even more so, now that the packer margin index has thrown a sweeping big curve ball. My projection of this past week's gross margin (which contraseasonally narrowed to $14.68 per cwt from $17.27 the week before) missed the mark by a full $5 per cwt. This does not exactly boost my confidence in my price forecasts.

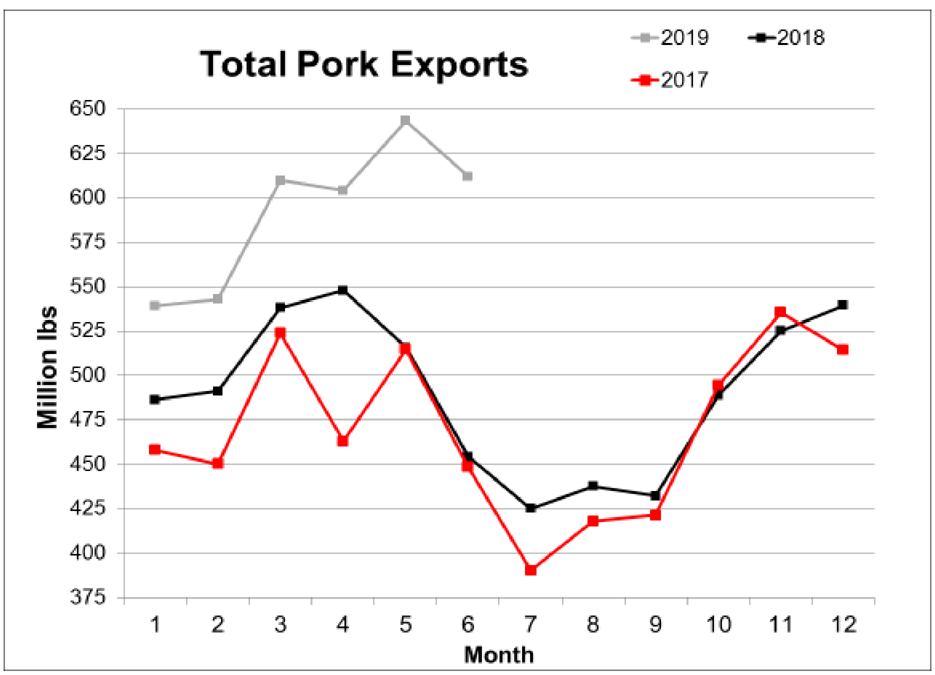
Is the February contract *really* worth $71? Well, let's yet take another look.

I'll begin with the simple observation that the CME Index averaged $62.94 per cwt this past week, and the notion of an $8 rally between the first week of November and the second week of February is not *that* far-fetched. On the next page I show the history of price changes during that interval since the carcass weight-based futures contract came into existence.



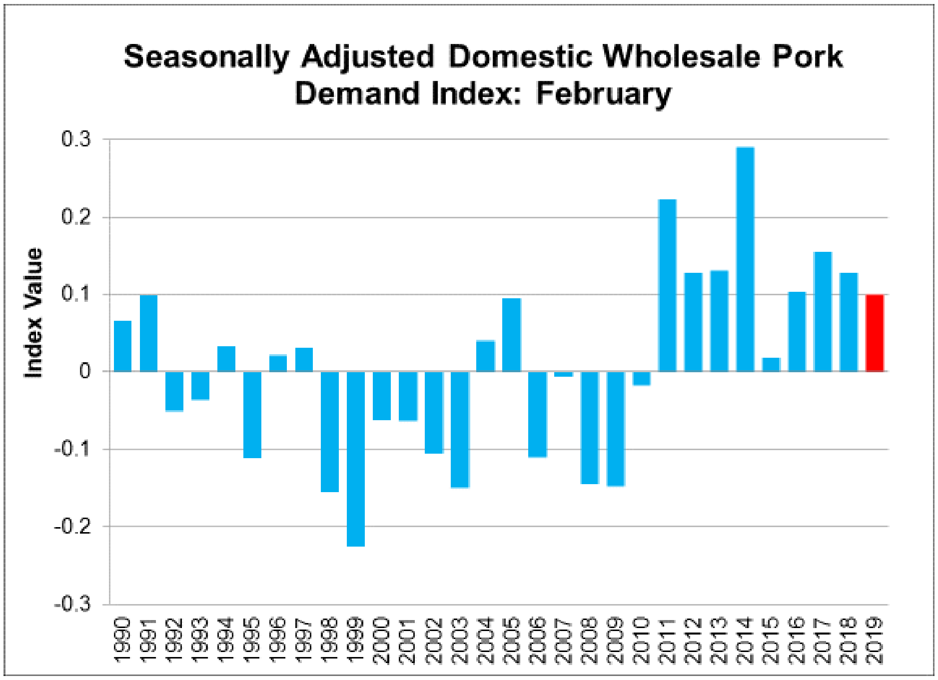
As usual, I am assuming that USDA's estimate of the summer pig crop was accurate, which places hog slaughter during February at about 2,450,000 per week. That would be 2.2% above a year earlier.

Next, I am building into the forecast a substantial acceleration in exports between now and February due to China's presumed need for imported pork, along with the expectation that Mexico's tariffs on U.S. pork will have been removed by then. This is kind of like throwing darts, but I think that a 50 million pound, year-over-year increase in total pork exports in February is a reasonable guess. I could go into a lot more detail on that subject, but I'll save the minutiae for another time. Anyway, I'll show you what I mean:



This combination of hog slaughter and foreign trade (also including pork imports amounting to 83 million pounds in February) results in a net domestic pork supply that is down 1.8% from a year earlier.

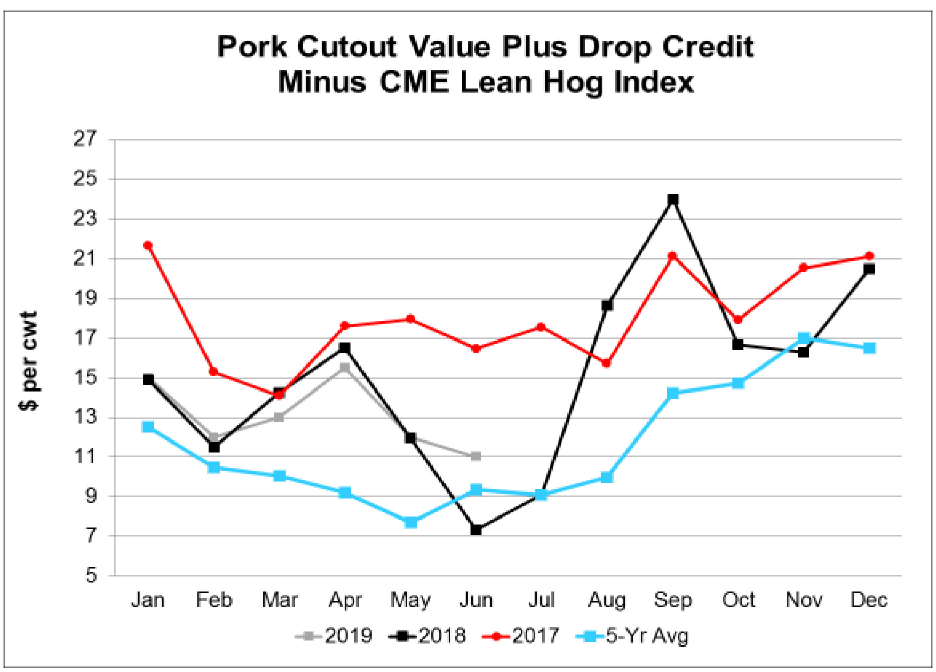
My assumption regarding wholesale pork demand is that the monthly demand index will be lower than it was in the last two years in February, but moderate in relation to the past eight years:



This would place the index value at about the same level as it stood in October. Another objective assumption, I think.

Combining supply and demand, then, the forecast of the pork cutout value in February becomes $78 per cwt.

Finally, then, comes the projection of gross packer margins. It could be reasonably argued that packer margins in February will be narrower than than a year earlier, because practical slaughter capacity likely will have expanded by then. I'm thinking primarily of a full second shift at Seaboard Triumph's new plant in Sioux City, and possibly at the Clemens plant in Coldwater, Michigan as well….and *possibly* a startup rate of production at Prestage Foods' new facility in Wright County, Iowa. But if I take a more conservative route and factor in a packer margin that is equal to a year earlier ($12 per cwt), along with a $5 per cwt byproduct credit, then I come up with an average CME Index of $71.



Forecasts:

	Nov*	Dec*	Jan*	Feb	Mar	Apr
Avg Weekly Hog Sltr	2,546,000	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	2,479,000	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	$69.50	$70.50	$76.50	$78.00	$75.50	$77.50
Year Ago	$81.18	$79.14	$80.74	$78.04	$72.71	$68.08
CME Lean Hog Index	$58.25	$54.75	$66.50	$71.00	$67.50	$67.00
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.