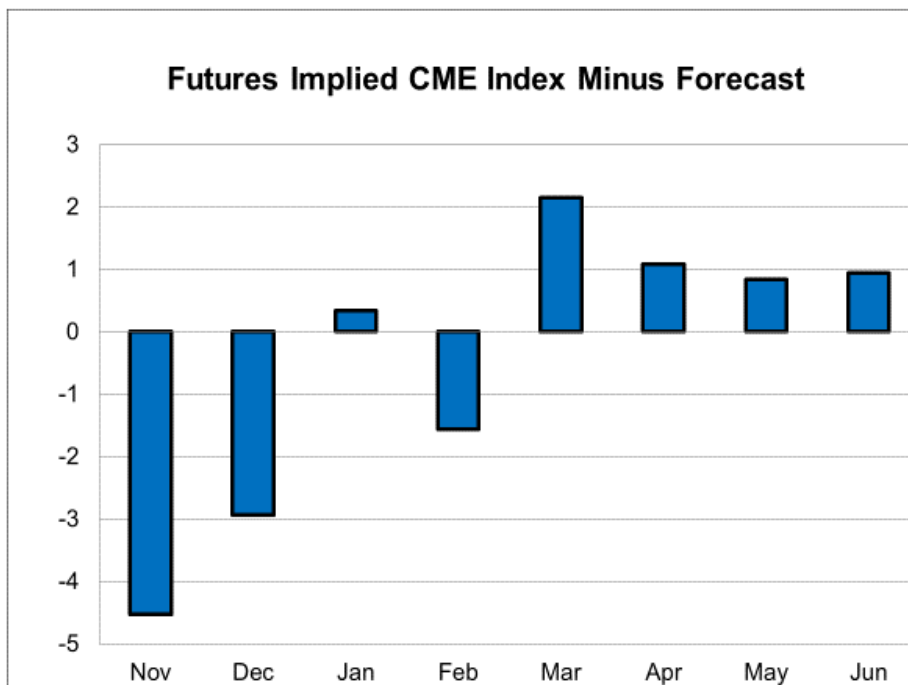


Trading Hogs

.... from a meat market perspective

A commentary by Kevin Bost

November 13, 2017

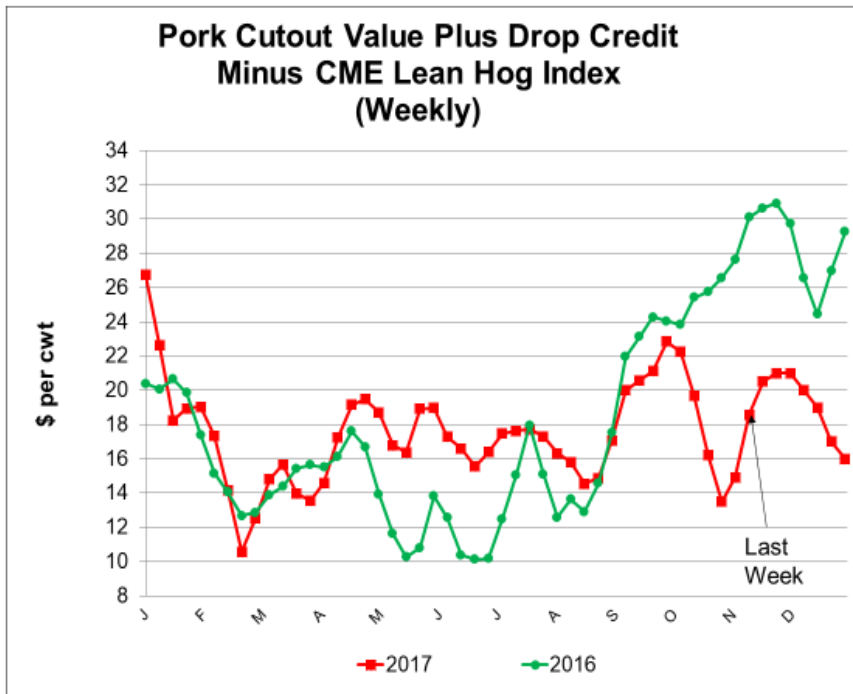


I am interested in the long December / short April spread, but only circumspectly. At this juncture, any long position in December hogs, or any spread involving a long leg in the December contract, must be approached with particular caution, because packer margins are

widening out again. The assessment that the board is undervalued, as depicted above, includes the critical assumption that quoted gross packer margins (pork cutout value plus byproduct value minus CME Lean Hog Index), which finished Friday at approximately \$20.50 per cwt, will not become appreciably wider. How confident am I about this assumption? Not very. This variable has behaved capriciously so far this fall.

I am fairly confident, though, that the three-week period into which we are now entering should bring about the most generous packer margins of the fourth quarter. Because of lighter-than-expected hog slaughter in the past two (and perhaps three) weeks, fourth quarter slaughter is now running a bit low in relation to the spring pig crop estimate. Given the unequivocal premise that hog supplies remain in a cyclical upswing, I suspect that the industry has recently “underkilled” the available supply, and that weekly slaughter will exceed 2,550,000 in each non-holiday week through the remainder of the year....and packers should have a relatively easy time putting together such a production schedule.

OK, so my forecast that the CME Index will stand in the neighborhood of \$65 when the December contract expires hinges on the notion that gross packer margins will be \$19-\$20 per cwt at that time. Remember that when the December 2016 contract went off the board, they



were \$25. They have been below a year earlier in each of the nine weeks since Labor Day, and this past week were down by \$11.50; so I have reason to doubt that they will reach \$25 by the middle of December. But if they were to do so, then the December futures contract would ultimately worth only about \$60.

Even so, the downside potential from Friday's closing trade of \$62.47 would not be great. I do not intend to buy December hogs outright, but the long December / short April spread might still be a worthwhile play under the more bearish scenario. This spread has dropped from \$6.90 to \$11.57 per cwt within the last eight trading days, and appears likely to match or exceed its contract low of \$11.95. If it does, then I will probably buy it at that time. By the way, the widest that the premium of April over December hogs has been in the third week of November is \$14, that occurring in 2008; the widest it has been in the second week of December is also \$14, that occurring in 2002. However, I notice that among the six years in which the April premium stood at \$10 or more in the third week of November, five times it narrowed from that point into mid-December—by an average of 350 points. [I should explain that when I say "ever", in this case I am talking about ever since 1999; that was when the futures contract first started settling to a carcass-based price.]

As for the cutout value, I still think that its buoyancy in the last two weeks has been directly related to the lighter-than-expected rate of production. Of course, if that is true, then bigger kills starting this week will put downward pressure on product prices—even bellies, which have been responsible for one half of the entire rally that has taken place in the cutout value since early October. Yet, I have no strong reason to think that wholesale pork demand will underperform through the balance of the year, and if it does not, then the cutout value will lose only about \$3 per cwt between now and mid-December.

Forecasts:

	Nov*	Dec*	Jan*	Feb	Mar	Apr
Avg Weekly Hog Sltr	2,497,000	2,559,000	2,417,000	2,376,000	2,372,000	2,321,000
Year Ago	2,515,100	2,370,900	2,361,900	2,327,100	2,326,700	2,285,400
Avg Weekly Barrow & Gilt Sltr	2,428,000	2,490,000	2,350,000	2,310,000	2,305,000	2,255,000
Year Ago	2,447,000	2,306,000	2,297,700	2,262,400	2,260,900	2,220,200
Avg Weekly Sow Sltr	62,000	62,000	61,000	59,000	60,000	59,000
Year Ago	61,000	58,500	59,900	58,400	58,900	58,100
Cutout Value	\$79.75	\$78.50	\$77.00	\$79.50	\$78.00	\$78.50
Year Ago	\$73.81	\$78.38	\$80.18	\$84.08	\$80.20	\$74.86
CME Lean Hog Index	\$65.75	\$65.50	\$67.50	\$71.50	\$71.00	\$73.00
Year Ago	\$49.07	\$56.77	\$63.80	\$74.16	\$71.50	\$62.60

**Slaughter projections exclude holiday-shortened weeks*

Trading Hogs is published weekly by Procurement Strategies Inc., 99 Grover Road, Elgin IL 60120. For subscription information, please contact Kevin Bost at (847) 212-7523 (cell), (224) 227-6281 (office) or Kevin_Bost@comcast.net; or visit our website at www.procurementstrategiesinc.com.

Information herein is derived from sources believed to be reliable, with no guarantee to its accuracy or completeness. Opinions expressed are subject to change without notice. Each investor must consider whether this is a suitable investment. All funds committed should be risk capital. Past performance is not necessarily indicative of future results.