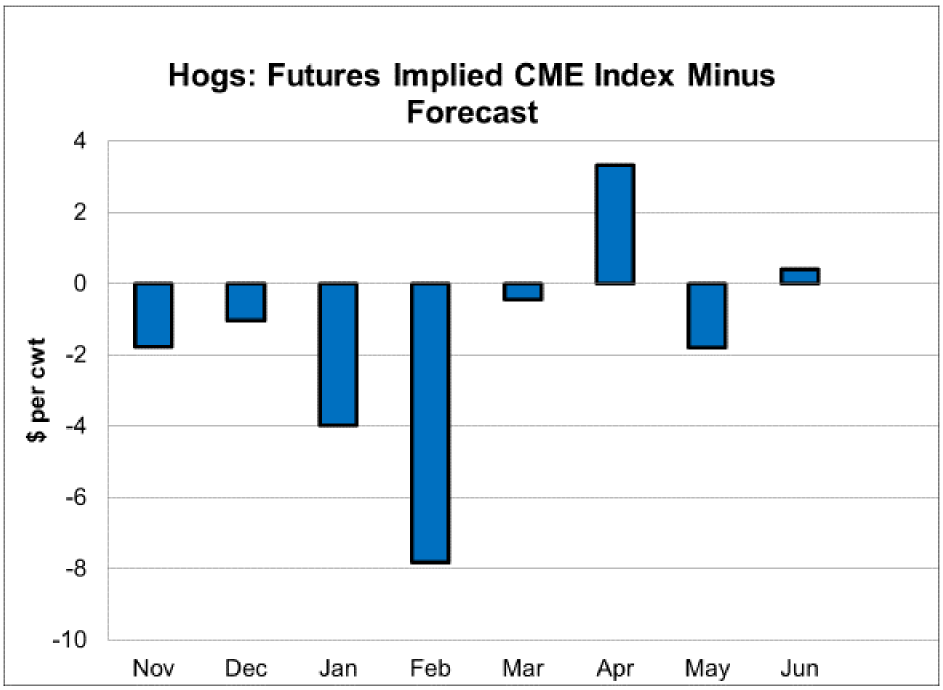
Trading Hogs
…. from a meat market perspective

A commentary by Kevin Bost

November 3, 2018



It is a bit frustrating to observe such volatility in hog futures (they have covered a range of 900 points over the past two weeks) without participating. But I must constantly remind myself that practically all of the key variables in the pricing equation are surrounded by an extraordinary degree of uncertainty. Under such circumstances, sound money management requires an extraordinarily favorable risk: reward proposition before I can justify laying my money on the table.

And so, as overvalued as the February contract appears to be, it will have to come down quite a bit farther before I will be willing to pull the trigger. Also, the cash price forecasts shown in the table below—against which the ultimate value of each futures contract is being measured—include the assumption that U.S. pork exports will begin to increase sharply soon after the first of the year. Since I am considering a long-side play, I have to assume that there will be *no* such increase in exports until next spring. By mechanically reducing first quarter export projections, I come up with an ultimate value for the February contract of $70 per cwt; but in reality, it would be something lower than that because of the ancillary impact on demand. In other words, wholesale demand readings likely would be stronger in the "bullish export" scenario than in the alternative scenario.

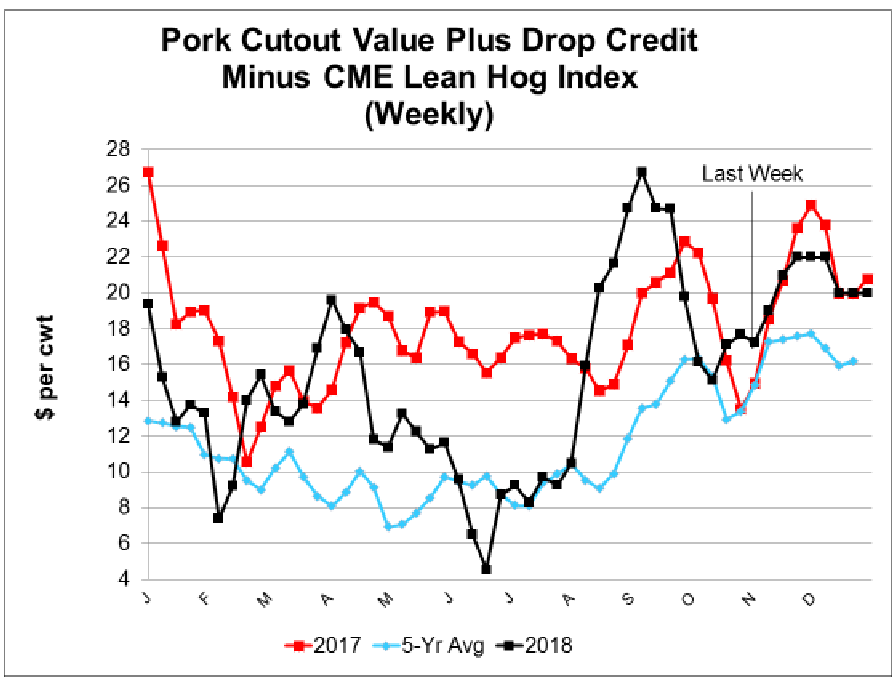
Noting, then, that February futures probably belong near the current contract high ($68.72 per cwt), I have to choose a technically meaningful stop-loss point in order to assess the risk: reward ratio. Under the circumstances, I am requiring at least 5:1 odds.

OK, so the only place for a stop-loss that I would regard as "technically meaningful" would be $58.77, the low of October 22. Assuming that a close-only stop at $58.77 might mean an actual exit price of $58.00, a 5:1 profit-to-loss ration would require an entry point of $59.50-$59.75. I remain very much aware of the gap on the daily chart at $56.57, and this gap will almost certainly be filled if the market does drop below $58.77. I would probably buy February hogs again around $56.00. But I'm getting ahead of myself. There are two reasons why I am not simply wating for the gap to be filled: 1) if February futures are indeed worth something near $70, then there is a decent chance that the $58.77 support level will hold up; and 2) whatever it may turn out to be, the low point in the cash hog market is *probably* no more than three weeks away. If it had been six weeks, I would wait for the gap at $56.57 to be filled.

In my humble estimation, the CME Lean Hog Index will start out this coming week at about $64.00. My guess is that the bottom will be in the $56-$57 range. That would be accompanied by a pork cutout value of about $73.50, which is only $1.50 per cwt below Friday's quote. If pork bellies are to drop to $1.10 per pound from the current reading of $1.32, it would shave roughly $3.50 off the cutout value; thus a $73.50 bottom in the week of Thanksgiving would require some upticks in other products. That help would most likely come from the ham market and lean trimmings.

The notion of a $73.50 cutout value in the week of Thanksgiving, by the way, assumes that wholesale pork demand follows a normal seasonal course over the next three weeks, while hog slaughter proceeds at 2,600,000 in the week ahead and 2,650,000 in the following week.

As for spot packer margins, my basic assumption is that they will expand from this past week's average of $17.24 per cwt to $22.00 at their next peak. Thus the combination of a $73.50 cutout value and a $4.90 per cwt byproduct credit, would align with a CME Lean Hog Index of $56.50.



Forecasts:

	Nov*	Dec*	Jan*	Feb	Mar	Apr
Avg Weekly Hog Sltr	2,550,000	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	2,483,000	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	$74.00	$74.75	$77.00	$79.50	$78.50	$78.00
Year Ago	$81.18	$79.14	$80.74	$78.04	$72.71	$68.08
CME Lean Hog Index	$58.00	$59.25	$67.00	$72.50	$70.50	$67.50
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.