

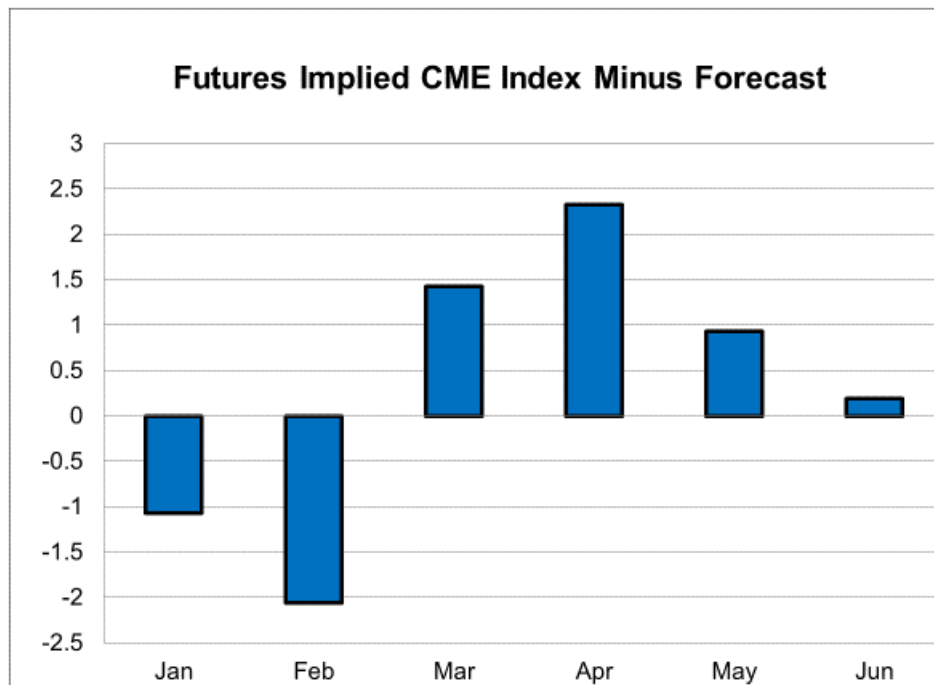
# Trading Hogs

## .... from a meat market perspective

A commentary by Kevin Bost

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December 19, 2017



By way of a rare stroke of good fortune, I was able to sell April hogs at \$73.50 yesterday. It was a small window. Maybe there will be ample opportunity to sell at that price again, and should there be, I am willing to hold this position through Friday's *Hogs and Pigs* report—a

prospect which I do not savor. However, if the market should move down to the 100-day moving average (which stands today at about \$71.25) before the report, I will cover the short position and wait for either another rally or a close below \$70.62 to sell into again.

I am not wildly bearish of April hogs, as they appear to be only mildly overvalued at this morning's trade levels. But I am ensnared by the prospect of a massive double top formation on the daily chart which, if completed, would measure down to \$65.35. Double tops and bottoms have been among the most reliable chart formations in the livestock markets over the years. That target may be far below this contract's ultimate value, but then the board can trade at whatever premium or discount it chooses until it is forced to reconcile—and that point is about three months down the road in this case. The long position among large speculators accounts for a considerable 17% of total open interest, leaving room for substantial long liquidation. By the way, April futures are carrying a premium of nearly \$10 per cwt to the CME Lean Hog Index as of this morning; since the carcass weight-based futures contract came into existence in 1999, only three times has the premium materially exceeded \$10 in the middle of December; the 15-year average is \$7.50.

Otherwise, I do not plan to make any trades in the hog market until after Friday's report.

As much as anything else, I am paying attention to the major support and resistance levels on the charts of the CME Lean Hog Index and the pork cutout value. In the case of the former, the major support lies at the September low of \$54.16 per cwt, and major resistance at \$69.44, the high of October 31. In the case of the latter, major support lies at \$72.45 (September 28) and major resistance at \$84.78.

It is difficult to reason why wholesale pork demand should not be able to maintain a normal seasonal trajectory through the first quarter. Retail pork prices in November stood significantly above a year earlier, but they are clearly declining. If a perfectly, seasonally normal demand pattern prevails, and if hog slaughter aligns well with the existing summer pig crop estimate—which, of course, could be revised on Friday—then the cutout value will average only slightly higher in January and February than it is right now. Thus, the prospect of a rising cash hog market after the holidays is entirely dependent upon seasonally shrinking packer margins....which is a pretty good bet. My forecasts of the CME Index assume that gross packer margins in January will be \$4 per cwt narrower than last week's average, and \$6 narrower than a year earlier. The rationale, of course, is based on the additional slaughter capacity. It is my understanding that the new plants in Sioux City, Iowa and Coldwater, Michigan will both be operating at full, single-shift capacity by February.

And this leads me back to the long February/short April spread. My primary interest in this spread is based on the notion that the February contract is undervalued while the April contract is overvalued by a similar amount. It would seem that the best time to enter the spread would be when the cash hog market begins to bottom out, which I'm guessing will be in the week ending January 6. However, I will not wait that long if the April premium moves out to \$6 per cwt in the meantime. That is a rather long way from the current premium of \$4.50, but neither the chart nor the near-term fundamentals suggests that this bus is leaving any time soon....

Forecasts:

	Jan*	Feb	Mar	Apr	May*	Jun
Avg Weekly Hog Sltr	2,431,000	2,366,000	2,372,000	2,321,000	2,296,000	2,236,000
Year Ago	2,361,900	2,327,100	2,326,700	2,285,400	2,250,200	2,183,400
Avg Weekly Barrow & Gilt Sltr	2,365,000	2,300,000	2,305,000	2,255,000	2,230,000	2,170,000
Year Ago	2,297,700	2,262,400	2,260,900	2,220,200	2,185,200	2,117,200
Avg Weekly Sow Sltr	60,000	59,000	60,000	59,000	59,000	59,000
Year Ago	59,900	58,400	58,900	58,100	57,900	58,800
Cutout Value	\$76.50	\$77.50	\$76.50	\$77.00	\$80.50	\$86.50
Year Ago	\$80.18	\$84.08	\$80.20	\$74.86	\$84.92	\$97.04
CME Lean Hog Index	\$65.50	\$69.00	\$69.00	\$69.50	\$76.00	\$81.00
Year Ago	\$63.80	\$74.16	\$71.50	\$62.60	\$72.28	\$86.09

*\*Slaughter projections exclude holiday-shortened weeks*

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