

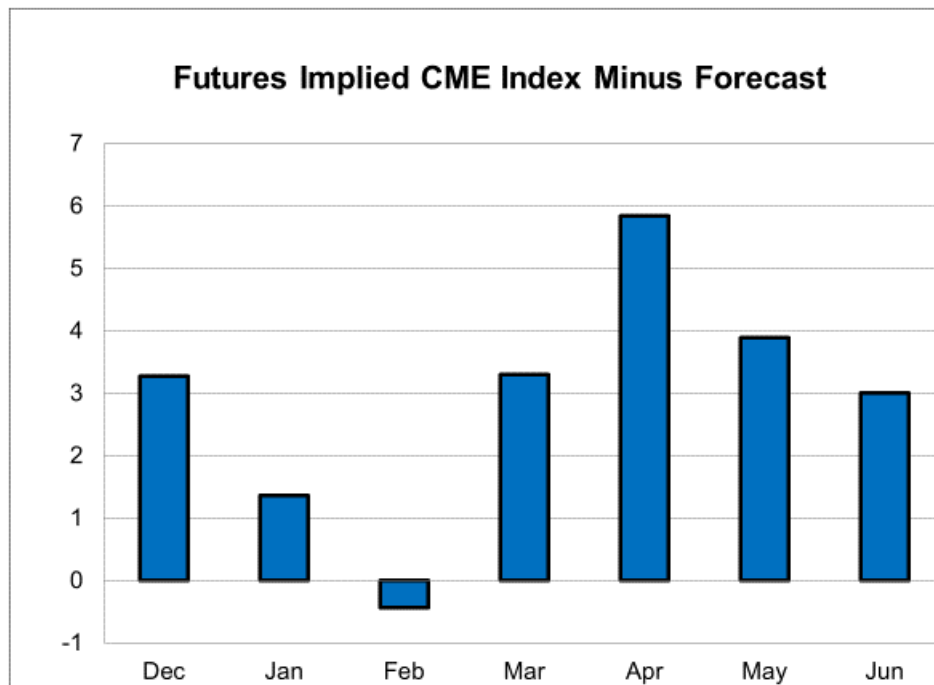
# Trading Hogs

## .... from a meat market perspective

A commentary by Kevin Bost

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December 3, 2017



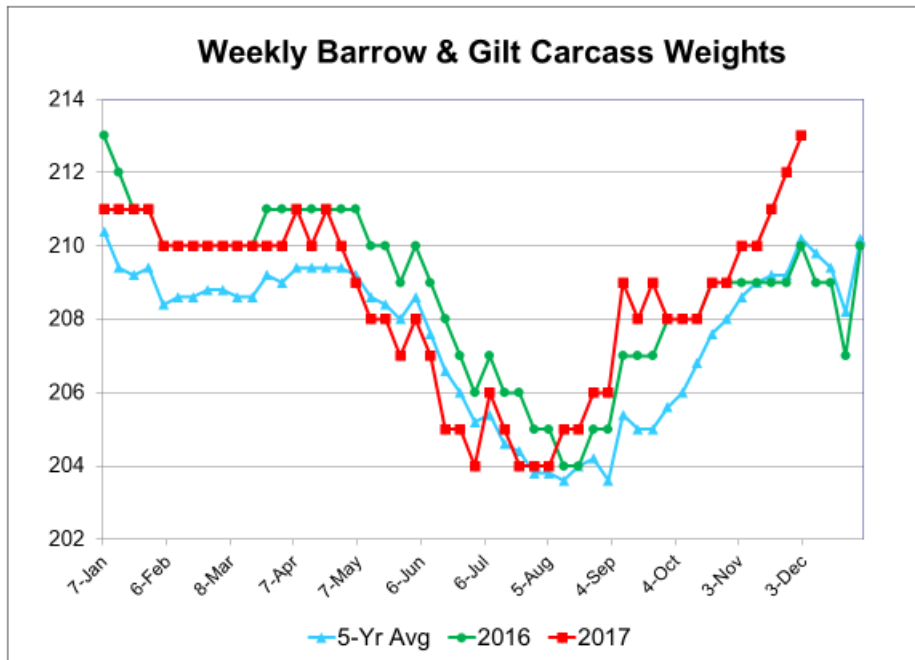
I was lightly positioned on the short side of December \$60 puts and \$64 calls until I stepped aside on Friday. I was prompted to do so by an upturn in the CME Lean Hog Index, which gained about \$1.00 per cwt during the week; and another light kill relative to the spring pig

crop estimate. Together, they injected enough doubt into the outlook that I no longer thought it advisable to bet on a sub-\$64 Index two weeks from now, when the December options expire—even though my guess is that the recent upturn in cash hog quotes will proved to be short-lived, and the Index will wind up at \$62-something as the December contract goes off the board. As best I can tell, the single-day Index value for Monday's kill stands in the neighborhood of \$64.30 per cwt.

The idea of selling December \$66 calls is somewhat attractive, but at the moment, the potential payoff does not appear to be large enough, nor the case strong enough, to bet my money on that proposition.

Now, it is quite common for cash hog prices to gain ground in the week after Thanksgiving; this has happened in 19 of the last 22 years. But if hog supplies were being backed up into Thanksgiving, then one would *think* that packers would not have to pay up at all to assemble a slaughter total of 2,535,000, which was actually a tick below the same week last year. At the same time, though, the daily LM\_HG201 report (National Daily Direct Hog Prior Day – Slaughtered Swine) indicates that carcass weights this past week were three pounds heavier than a year ago, and have increased at a faster-than-usual pace since the first of November. I notice also that gross packer margins widened another \$1.30 per cwt, and have increased \$10

over the past four weeks. Based on their historical behavior between Thanksgiving and Christmas, my guess is that they will not change much until the final week in December, when they should begin to tighten.



Adding to the uncertainty is the fact that the behavior of the pork cutout value through the end of the year and beyond will be dictated by pork bellies. It is a good bet that ham prices will drop to \$50-\$55 by the first week in January, which would subtract \$3.25 to

\$4.50 per cwt from the cutout value. That much can be nearly offset by 10¢ gains in loins and butts, which is fairly common between now and then. The belly market will be the “swing factor”. It moved up more than 45¢ per pound in November, presumably making it susceptible to a material setback in the near term, and greatly reducing the chances of a first quarter rally of the ilk that we saw last year. Each 10¢ move in belly prices affects the cutout value by roughly \$1.60 per cwt.

From a broader perspective, the domestic wholesale demand index appears to be reaching a cyclical peak here in November/December, implying that the next cyclical move will be downward. It is this notion that leads to my negative stance toward the cutout value in the first quarter. [A flat or weak pork belly market naturally figures into that equation.] Of course, we should expect a seasonal tightening of packer margins at the same time, which should be enhanced as the two newest pork plants reach full, single-shift capacity.

By virtue of the picture on the first page, there are two plays worthy of serious consideration at this juncture. One is the long February/ short April spread; the other is an outright short position in April hogs. In regard to the former, the spread chart suggests that an entry point in the \$4.50-\$4.80 per cwt range (premium to the April contract) would be advisable. In case you’re wondering, the 15-year average of this spread during December is \$3.77, and in January it is \$4.10. As for the outright short trade in April hogs, this market just might be forming a major double top from \$75.80-\$75.90 per cwt. I plan to sell this one as closely as possible to that price level with a close-only stop—actually two closes—above \$76.00.

Forecasts:

	Dec*	Jan*	Feb	Mar	Apr	May*
Avg Weekly Hog Sltr	2,555,000	2,431,000	2,366,000	2,372,000	2,321,000	2,296,000
Year Ago	2,370,900	2,361,900	2,327,100	2,326,700	2,285,400	2,250,200
Avg Weekly Barrow & Gilt Sltr	2,485,000	2,365,000	2,300,000	2,305,000	2,255,000	2,230,000
Year Ago	2,306,000	2,297,700	2,262,400	2,260,900	2,220,200	2,185,200
Avg Weekly Sow Sltr	62,000	60,000	59,000	60,000	59,000	59,000
Year Ago	58,500	59,900	58,400	58,900	58,100	57,900
Cutout Value	\$80.25	\$77.75	\$79.50	\$77.00	\$76.00	\$80.00
Year Ago	\$78.38	\$80.18	\$84.08	\$80.20	\$74.86	\$84.92
CME Lean Hog Index	\$62.25	\$67.00	\$71.00	\$70.00	\$68.50	\$75.50
Year Ago	\$56.77	\$63.80	\$74.16	\$71.50	\$62.60	\$72.28

*\*Slaughter projections exclude holiday-shortened weeks*

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