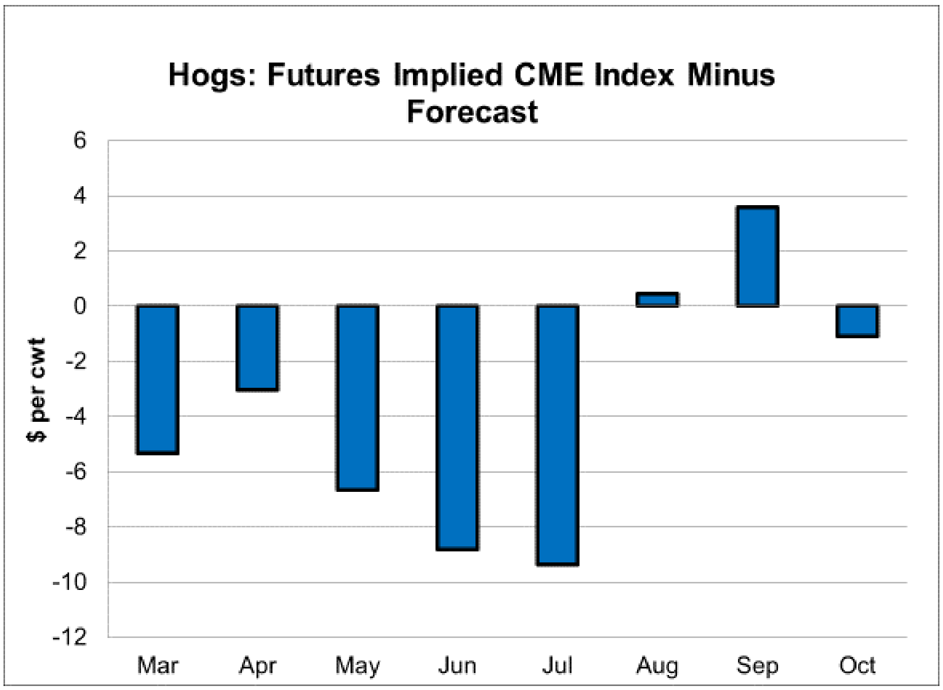
Trading Hogs
…. from a meat market perspective
A commentary by Kevin Bost

February 10, 2019



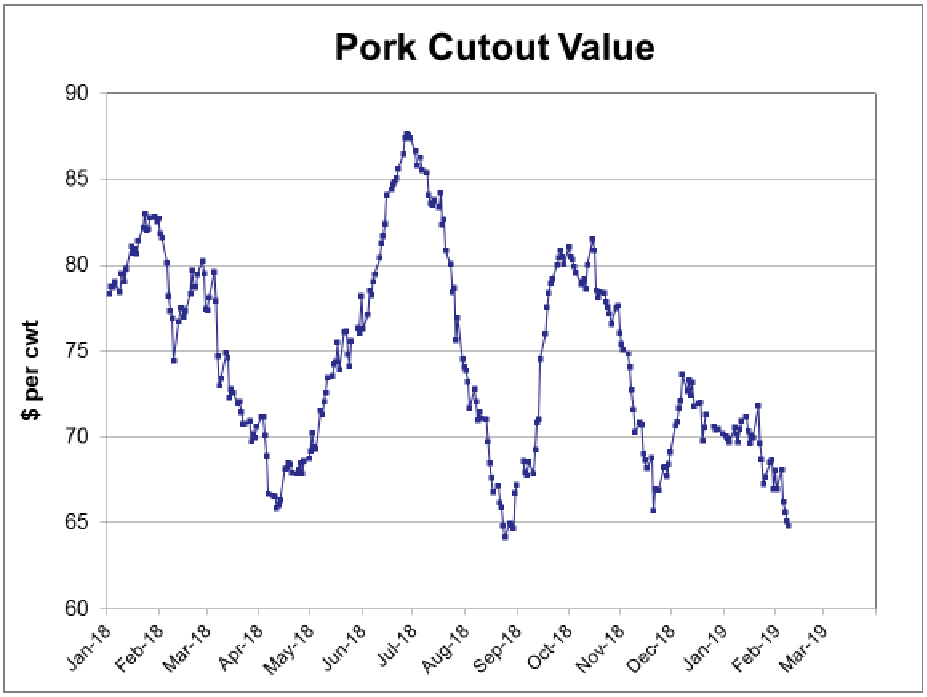
I lifted my short position in April hogs last Monday—with a profit, but one not as generous as it would have been had I stuck with the position. Yet, in the usual "post-mortem" I do not blame myself for covering up on such a high-volume, outside range reversal. It would have been a breakdown of discipline if I had ignored such a signal. In this case, it was just bad luck.

And so, expecting that last Monday's huge reversal marked the bottom, I proceeded with my plan to enter the April/June bull spread, as a lower-risk alternative to an outright long position. This position has not been particularly kind to me, either, as a drooping cash market has pulled the April contract downward.

So what now? The default strategy is to hold the spread until it registers two closes below $16.00 (premium to the June), expecting it to narrow to $13.50 and possibly $12.00. Those objectives remain reasonable targets, partly because $13.66 is the widest that this spread has ever been (on a weekly average basis) in the second week of February.

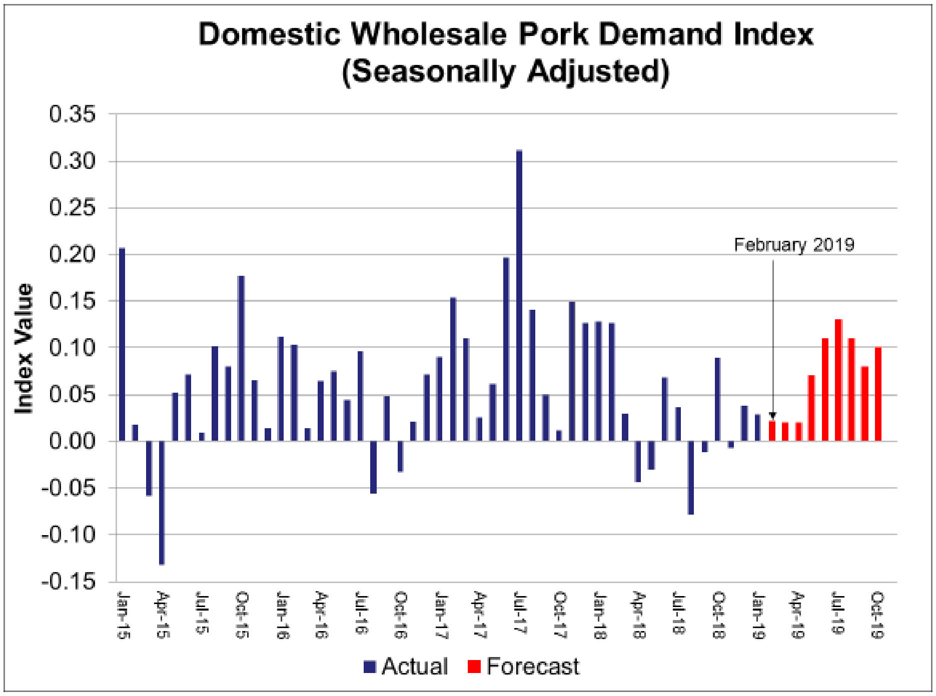
It is tempting to cover the short June leg and thereby convert this into an outright long position. But I remind myself that the initial plan was to play the long side of the April contract via the bull spread if April hogs traded near $58.25, preferring the spread because April futures do not appear to be *that* far undervalued. I shall adhere, then, to the original strategy.

However, I have to think there is a good chance that the cash markets are on the verge of a turn back upward. The most conspicuous suggestion comes from the chart of the pork cutout value, which now stands at an obviously major support level:



Given that hog slaughter should decline from this point, to an average of about 2,470,000 through the balance of February; and given that hams, bellies, butts, boneless picnics, and lean trimmings all trade anywhere from 11¢ to 23¢ per pound below a year ago; there seems to be a good chance that the next move will be upward….doesn't there?

The forecast of a $61.50 average CME Lean Hog Index in April is pretty conservative with respect to demand, as I show in the picture on the next page. It makes sense to me that if demand is to diverge from its typical seasonal course between now and then, it is more likely to be a bullish divergence than a bearish one—simply because prices are undeniably cheap. If the monthly demand index were to merely return to its December standing, then we probably would be looking at an average cutout value of $74 per cwt in April and, with gross packer margins a couple dollars wider than they are now, a CME Index of $63. There remains an elusive gap on the daily chart at $63.42….



Forecasts:

	Feb	Mar	Apr	May*	Jun	Jul*
Avg Weekly Hog Sltr	2,482,000	2,468,000	2,403,000	2,321,000	2,284,000	2,244,000
Year Ago	2,396,090	2,403,610	2,370,400	2,258,700	2,220,400	2,160,700
Avg Weekly Barrow & Gilt Sltr	2,414,000	2,400,000	2,335,000	2,255,000	2,215,000	2,180,000
Year Ago	2,330,170	2,338,350	2,304,900	2,195,200	2,154,700	2,099,000
Avg Weekly Sow Sltr	61,000	61,000	61,000	59,000	61,000	57,000
Year Ago	58,640	58,540	58,500	56,600	58,400	54,700
Cutout Value	$68.00	$71.00	$72.50	$82.00	$89.00	$91.50
Year Ago	$78.04	$72.71	$68.08	$73.59	$83.18	$82.70
CME Lean Hog Index	$57.50	$60.75	$61.50	$73.00	$83.00	$86.00
Year Ago	$71.61	$63.51	$56.47	$66.77	$81.13	$78.73

**Slaughter projections include holiday-shortened weeks*

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