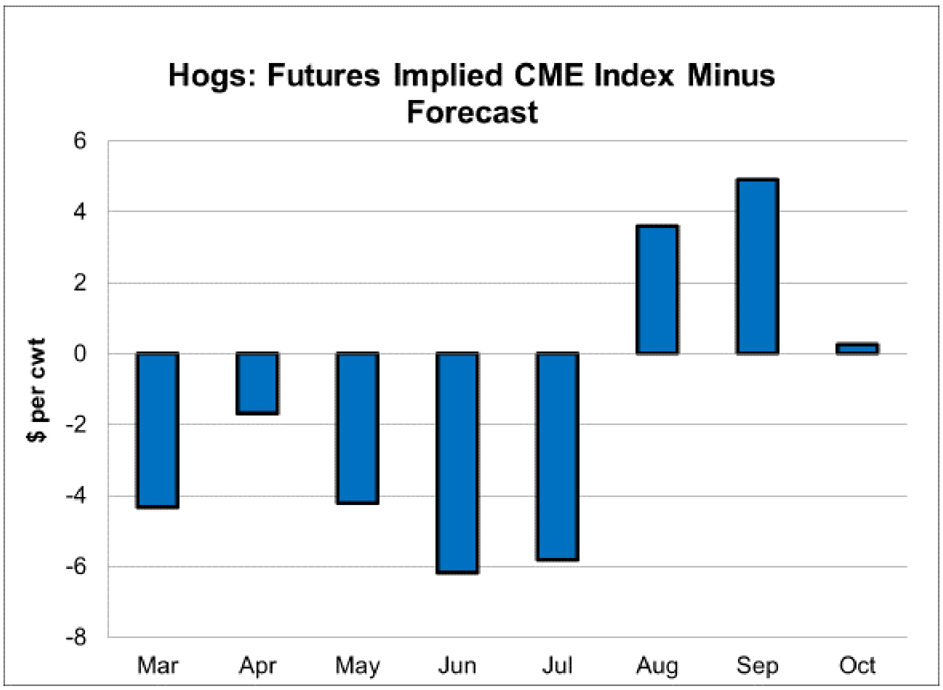
Trading Hogs
…. from a meat market perspective
A commentary by Kevin Bost

February 18, 2019



First of all, I still intend to confine my bets to the front-end of the market, since the deferred contracts are so heavily dependent on the timing and quantity of export business--about which I can do little more than guess at this point, and there is no room for gambling in my capital management scheme.

There is one exception to this restriction: I am willing to trade from the long side of any contract that is substantially undervalued *relative to the forecast that excludes any material increase in exports to China*. In other words, I can justify buying contracts that are likely to appreciate even if the *status quo* remains in place with respect to pork exports. And that includes Mexico; the removal of the Mexican tariff on U.S. pork is in Nancy Pelosi's hands, which automatically makes it difficult to predict when the new North American accord will be ratified.

One way to identify such entry targets is to simply replace the values assigned to exports and imports in the pricing equation. It's inexact, but it's realistic and purely objective. My focus is on the June, July, and August contracts, and these are the adjustments I have in mind:

- U.S. exports to China/Hong Kong/Taiwan are reduced to 2018 levels;
- U.S. exports to Mexico are reduced to levels that are only slightly above a year earlier, with the increase stemming from cheaper prices of hams and butts;
- Imports of pork from China are also reduced to 2018 levels. My current assumption is that when the Mexican tariff is lifted, Canada will lose some of its export business to Mexico and this product will find its way into the U.S.
- My current assumption is that when exports begin to increase sharply, demand at the wholesale level will be lifted. Thus, for the purpose of this exercise, I am adjusting the projected demand index downward so that it reflects a modest increase that could be expected because of declining retail prices and cheap prices earlier in the year.

OK, so when I make these changes to the equation, I come up with monthly average CME Lean Hog Index forecasts of $73.50 per cwt in both June and July, and $65.50 in August. Thus, the buy target in the June and July contracts would need to be in the neighborhood of $70. The buy target in the August contract is somewhere off the map.

I apologize for dragging you through so much detail, but such work has to be done if I'm going to seriously consider placing a long-side wager. And sadly, this is my idea of fun.

As for the April contract, I can only trade from the long side or as the long leg of a spread because both product prices and wholesale demand are extremely depressed. My forecasts assume only a very modest recovery in demand by April, and my instincts tell me that I am being overly conservative. When prices become this cheap, demand responds--*eventually.* Not knowing how long "eventually" might be, though, I have to use $61-something as the "fair value" benchmark….and this dictates, at least for the moment, that I restrict purchases to something near $58.00. If I do buy anything at that level, I will naturally place a lose-only stop at the contract low.

There is another factor that comes into play, and that is the composition of the market. The most recent *Commitments of Traders* data are four weeks old (due to the government shutdown), but they are worth referring to because at that time, the short position held by "Managed Money" traders accounted for 12.8% of the total "pie". This was its largest share since September 11, and the market has been pretty much straight down since then….so this share has probably increased in the meantime. Perhaps the boat is listing to one side….

Forecasts:

	Feb	Mar	Apr	May*	Jun	Jul*
Avg Weekly Hog Sltr	2,491,000	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	2,423,000	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	$65.25	$69.25	$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	$56.50	$61.00	$61.25	$72.50	$83.00	$86.00
Year Ago	$71.61	$63.51	$56.47	$66.77	$81.13	$78.73

**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.