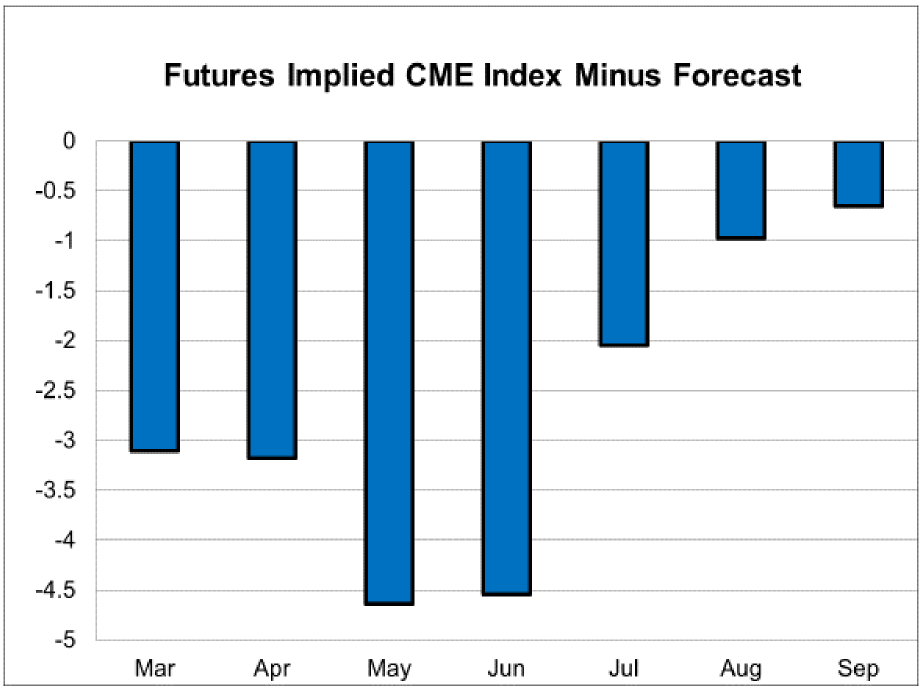
Trading Hogs
…. from a meat market perspective

A commentary by Kevin Bost

February 19, 2018



I am aggressively short of an April futures contract that appears to be undervalued, because the technical signals are overwhelmingly bearish. What I am betting on, then, is that the board will become even more undervalued before it hits bottom. Over the last eight trading sessions, it has fallen through a previously vital support level; rallied back to that same level, which has transformed into an area of resistance; closed below the low end of a conspicuous outside range/reversal; and now appears to be forming a bear flag that would measure down to approximately $66.25, as best I can tell. There is a gap on the daily chart of April hogs at $66.35.

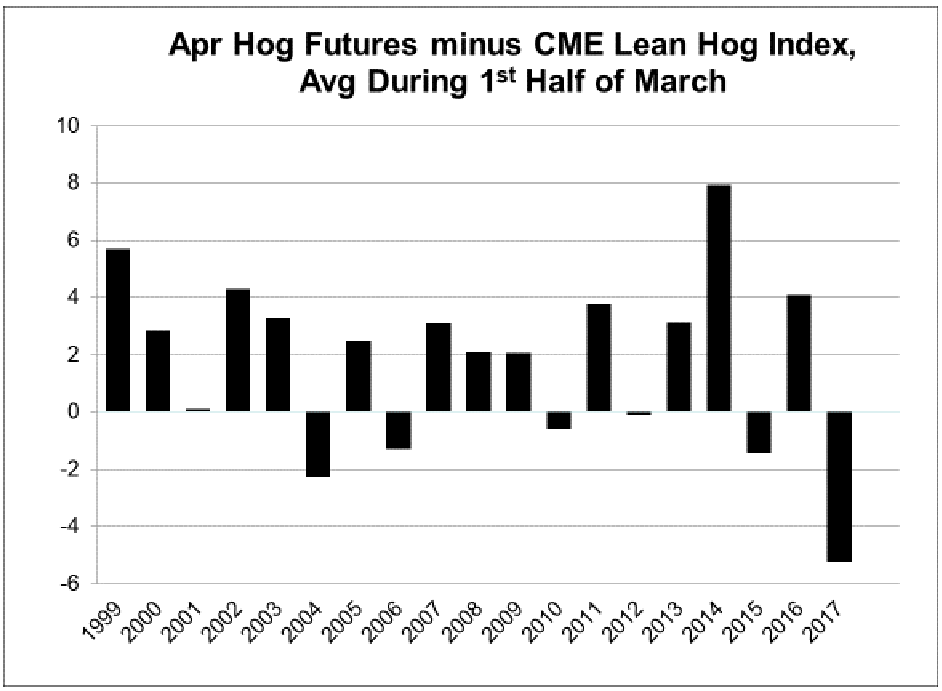
And so, it makes sense for me to remain short as long as, but *only* as long as, the $66.25-$66.35 objective remains intact. How will I know if the market is going to bottom out before then? An uptick in the CME Lean Hog Index might be enough to convince me. A close above the ten-day moving average would also be convincing; if the downside objective is to be reached, it will probably waste no time doing so.

But I will not wait for either of these developments before taking a defensive measure. I plan to sell April $67 puts, which finished Friday at $1.95 per cwt. That would ultimately nullify limit any profit potential below $65, but it is unlikely that the market will trade that low anyway. If the market should turn around right here, and if I were to sit on that position, then chances are that I would wind up with a net liquidation price of about $69.50 (assuming a "fair value" of $71.50 plus the put premium of $2.00).

On my wish list, however, is a plan to cover the outright short April position (either around $66.50 or upon one of the signals described above), and then enter into a long position in the June contract soon thereafter, retaining the short option position for the time being. God is probably laughing at my plans, but I have to make them anyway.

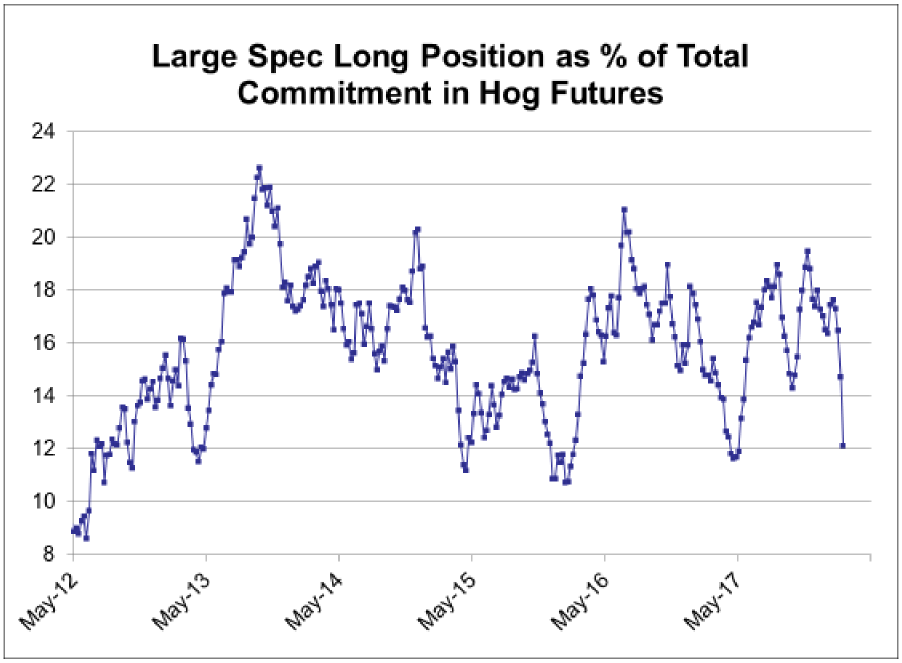
I notice that while the chart of the pork cutout value looks like it is headed for $72.50 per cwt—nearly $5 below Friday's quote—the chart of the CME Index looks like it could find a bottom at $70. I estimate that the single-day Index value for Tuesday's kill stands just under $71. It is possible that both conditions could be satisfied. If done simultaneously, then gross packer margins would have to narrow by about $3 per cwt from their current reading—taking them back down to where they averaged in the week before last. I suppose it's not all *that* hard to envision.

By the way, the necessary and sufficient condition for the cutout value to reach $72.50 would be for all bone-in hams to trade at $.55 per pound with bellies near $1.10 at the same time.



It might also be useful to take a look at the history of the futures-minus-cash basis during March. Clearly, it is unusual for the April contract to trade at a discount to the CME Index in the first half of March. However, I notice that the current discount is the second-largest for this time of year since 1999, when the carcass-based futures contract came into existence. The point is that there seems to be room for April futures to trade down to $66.25 even if the Index is indeed to bottom at $70.

Finally, market sentiment has shifted toward the bearish side over the last few weeks. This is one of the conditions that I had hoped to see before attempting a trade from the long side of the table. Over the past three weeks, the short position among large speculators has grown by about 13,000 contracts while the long position has decreased by 24,000; and as I show in the picture on the next page, the percentage of the total "pie" held by long speculators is now the smallest it has been since last May. I try not to read too much into the *Commitments of Traders* figures, but there *should* be materially less potential downward pressure on prices stemming from long liquidation.



Forecasts:

	Mar	Apr	May*	Jun	Jul*	Aug
Avg Weekly Hog Sltr	2,358,000	2,362,000	2,323,000	2,278,000	2,291,000	2,392,000
Year Ago	2,326,700	2,285,400	2,250,200	2,183,400	2,211,300	2,304,600
Avg Weekly Barrow & Gilt Sltr	2,290,000	2,295,000	2,255,000	2,210,000	2,225,000	2,325,000
Year Ago	2,260,900	2,220,200	2,185,200	2,117,200	2,149,300	2,241,600
Avg Weekly Sow Sltr	61,000	60,000	61,000	61,000	59,000	59,000
Year Ago	58,900	58,100	57,900	58,800	55,000	55,500
Cutout Value	$76.50	$77.50	$84.50	$90.00	$88.50	$88.50
Year Ago	$80.20	$74.86	$84.92	$97.04	$103.48	$91.67
CME Lean Hog Index	$70.50	$71.50	$79.50	$84.50	$83.00	$82.00
Year Ago	$71.50	$62.60	$72.28	$86.09	$91.47	$81.41

**Slaughter projections exclude 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.