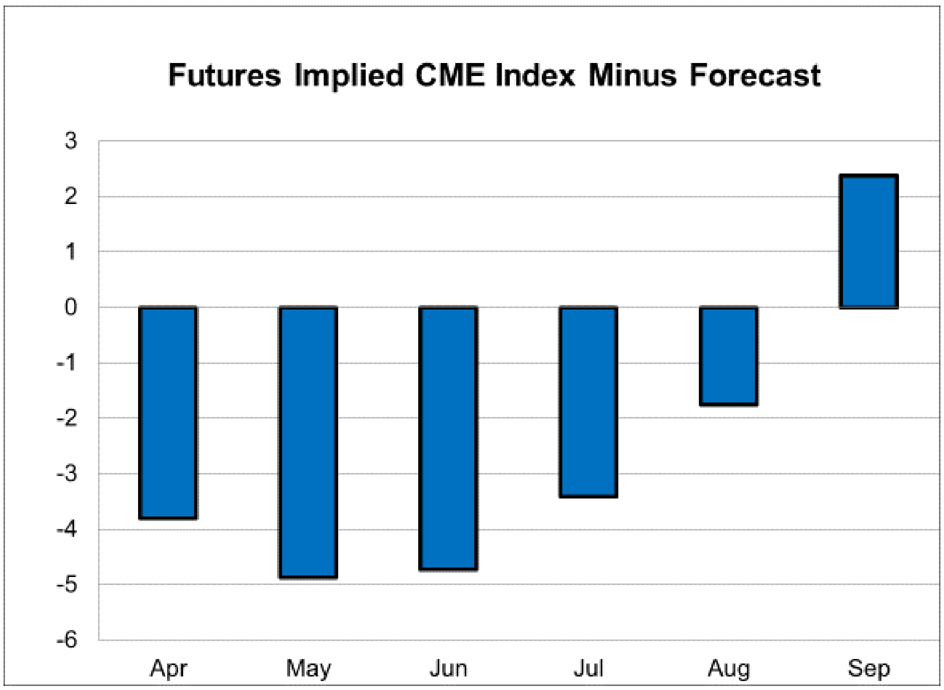
Trading Hogs
…. from a meat market perspective
A commentary by Kevin Bost

March 21, 2018



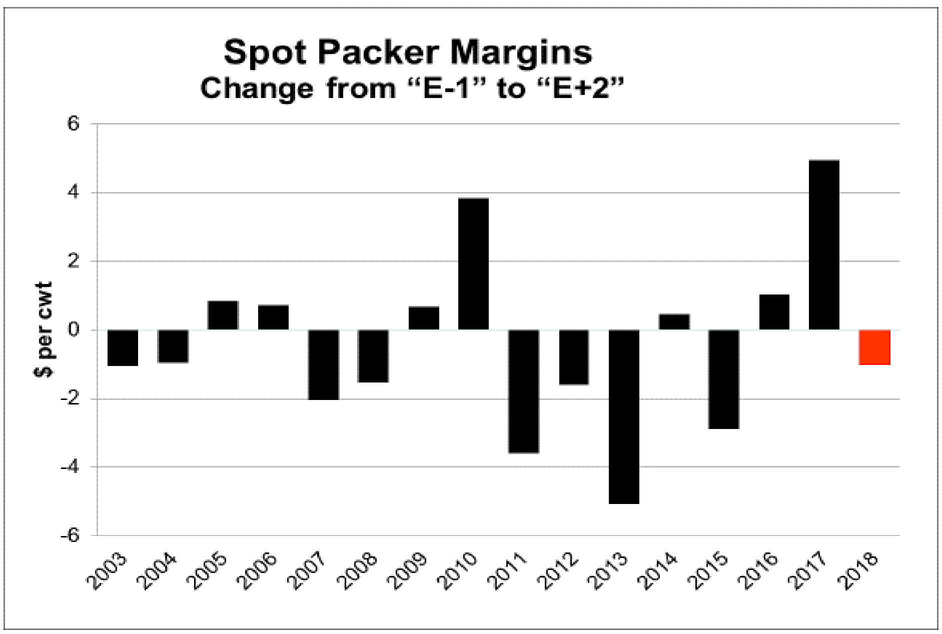
As many attempts as it took for the April contract to fill its gap at $65.35, it suddenly became very easy to buy it at that point, which I did last Friday. I wish I had waited one more day. The market has now registered three closes below the previous contract low, and yet I remain long of April hogs. Why? I have been forced to ask myself that question many times in the last three days. This is a violation of basic capital management guidelines. I am well aware of the possibility that the price action on the board could be signaling that one or more of my key assumptions regarding supply and demand in the near term is errant. But even if that is to be the case; and even though I have lowered my sights for the cash hog market on April 13; then what are the chances that April hogs will make another major leg down from here? My conclusion is that they are quite small; hence the existing long position.

My “damage control” tactics are now a matter of detecting a significtanly adverse and surprising development in the cash market. What would constitute such a development? One would be if ham prices were to fail to “catch” at $.50 per pound (or a tick below), or if bellies failed to hold at $1.00 per pound (or a tick below). One would be a major slippage in the pork loin market, which I assume to be on solid footing and capable of launching into its seasonal rally a bit earlier than usual. Another would be a ballooning of packer margins, which I also expect to hold basically steady.

As I estimate that the single-day CME Lean Hog Index for tomorrow’s kill will be $62.00, the April futures contract is carrying a roughly $.50 per cwt premium to the cash market. Thus, the board is telling us that there will be virtually no net change in the Index over the next three weeks.

Let's think about this. First of all, my expectations include that weekly kills from this week to the second week of April will be 2,415,000-2,360,000-2,360,000-2,350,000. And so, there should be a reduced amount of supply-side pressure on the cutout value in the weeks ahead. Therefore, any further declines of any substance in the cutout value should have to come from the demand side. I am expecting the demand for hams and bellies to be quite strong at $.50 snd $1.00 respectively. [They were quoted today at $.52 and $1.05.] Ham prices have a very consistent tendency to strengthen between Holy Week and the second week after Easter. The track record of the belly market shows no bias in either direction. By the way, pork bellies have been consolidating for eleven trading days now, and hams for seven trading days. Essentially, the cutout value should be on bottom right now.

Quoted gross packer margins stand at $14 per cwt , up from $12.79 last week but even with the average of the past four weeks. This week's increase is a bit disconcerting, and right now, this is the factor that seems most likely to throw my $66.50 ultimate valuation of the April contract "out of bounds". I am factoring in a $13 gross margin in the second week of April. There is no consistent seasonal bias in packer margins from the week we are in now ("E-1" in the picture below) to the second week after Easter ("E+2"); however, the 15-year average is a decline of $.42 per cwt:



But let's say that margins stay right where they are. In that case, the board is pricing in a cutout value of just under $71.50 in the second week of April (which is, of course, equal to today's quote). In only five of the past 15 years has there been a decline of $1 per cwt or more between now and the second week after Easter. Under the circumstances, the board is essentially saying that there will be no appreciation in ham prices between now and then.

These statistics are not overwhelmingly pointing to a substantial rally in the CME Index within the next three weeks. But once again, what are the chances of another major leg *downward* from here?

I am pwesuaded by the dreadful technical picture to turn my exit strategy into a "salvage operation"; and the salvage value is probably significantly higher than today's close. I consider also that the short position among large speculators (even as of a week ago, before this latest sell-off) exceeded the long position for the first time in nearly a year, leading me to think that the market is susceptible to a substantial short-covering rally….

Forecasts:

	Mar	Apr	May*	Jun	Jul*	Aug
Avg Weekly Hog Sltr	2,398,000	2,361,000	2,326,000	2,283,000	2,290,000	2,391,000
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	2,332,000	2,294,000	2,260,000	2,215,000	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	59,000	59,000	59,000	61,000	58,000	58,000
Year Ago	58,900	58,100	57,900	58,800	55,000	55,500
Cutout Value	$73.50	$75.25	$81.00	$87.50	$87.50	$87.00
Year Ago	$80.20	$74.86	$84.92	$97.04	$103.48	$91.67
CME Lean Hog Index	$65.00	$67.25	$75.25	$82.00	$82.00	$80.50
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.