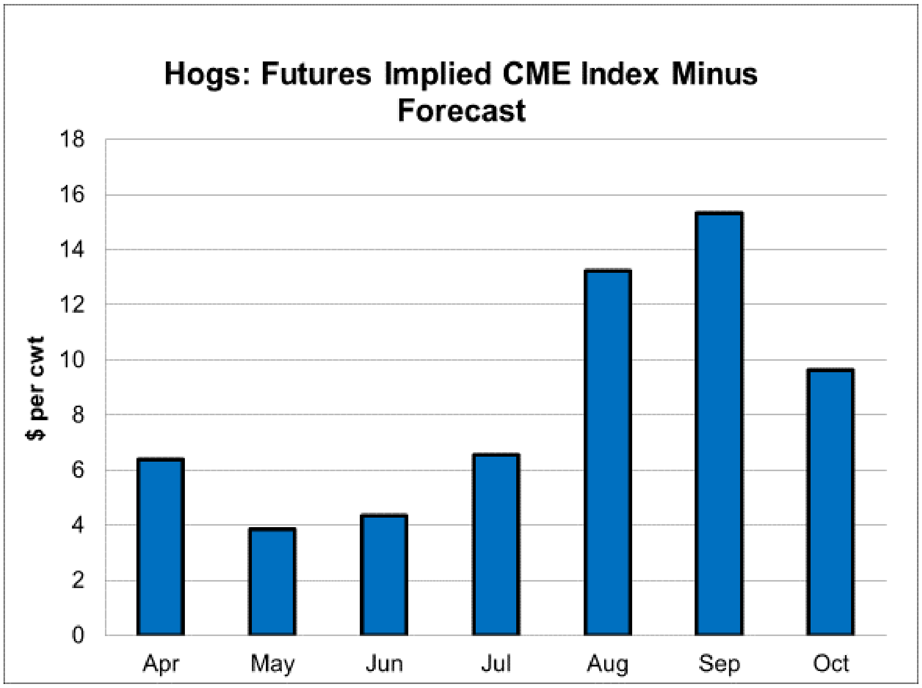
Trading Hogs
…. from a meat market perspective

A commentary by Kevin Bost

March 24, 2019

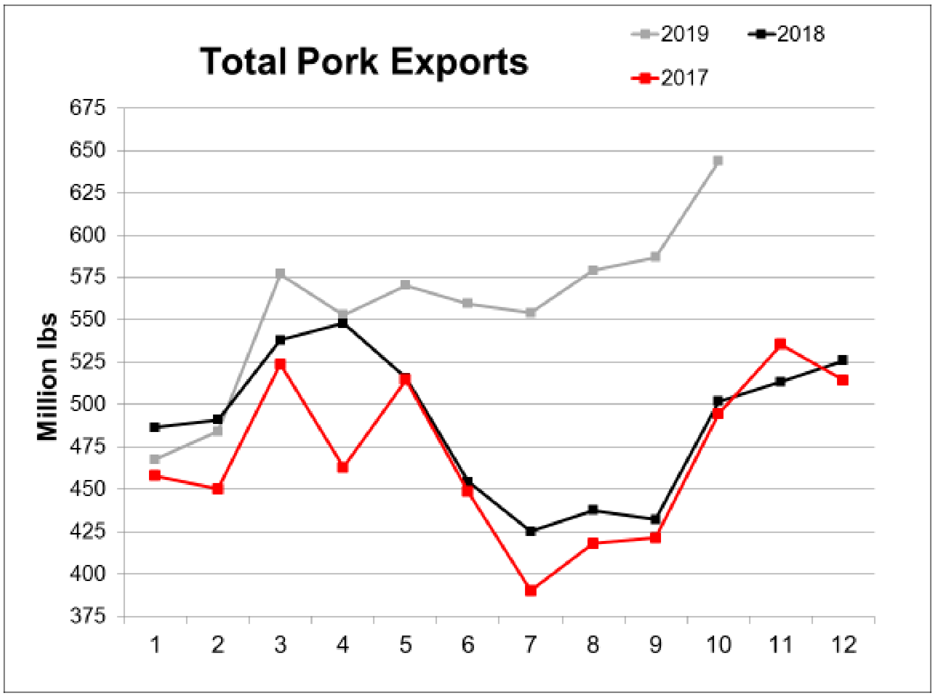


I have worked into my price forecast the most bullish set of assumptions regarding wholesale pork demand and export volumes that I can render without going recklessly overboard--and the August contract still looks like it is some $13 per cwt overvalued at Friday's close. Honest to God.

However, I do not plan to sell August hogs right away. While Friday's price action does indicate that the market may have accommodated all the short-covering and the new long hedge buying that it needs to for a while, the 60-minute charts remain in a distinct uptrend and do not indicate that Friday's action was anything more than a correction.

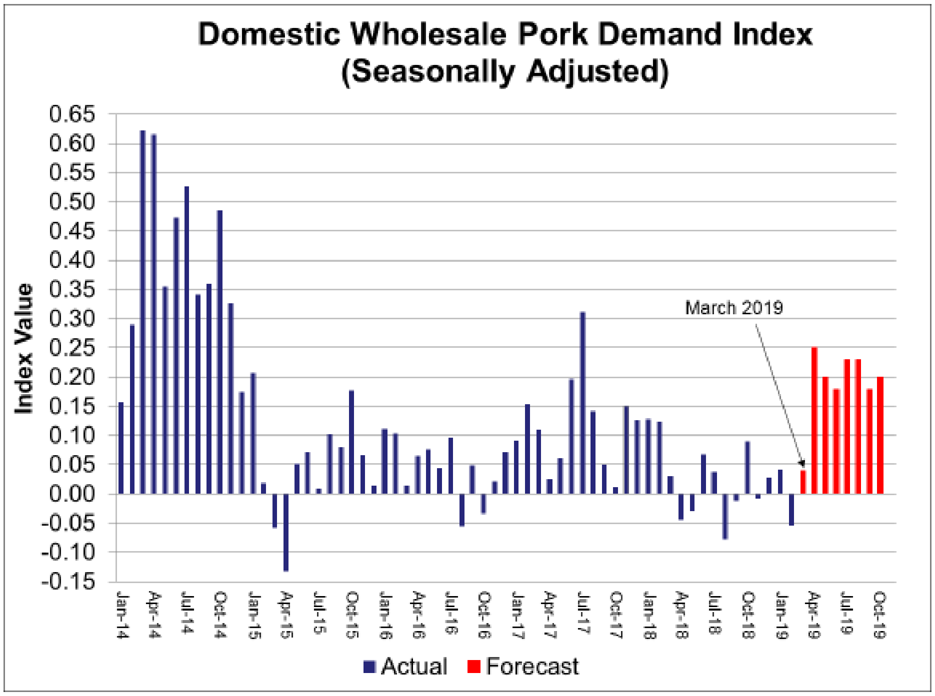
OK, so allow me to explain how I come up with a CME Lean Hog Index of $84-85 per cwt in August while the board trades near $100. I won't drag you through *all* the dreary details, just enough to allow youto follow my logic. And if you think I'm off-base, please let me know where!

I'll begin with the export projections. Included in the picture below is a rate of shipments to China/Hong Kong/Taiwan that climbs from 40 million pounds per month at the beginning of the year to 120 million pounds in June, 150 million in August, and 160 million in August. The second, third, and fourth quarter increases under this scenario (compared with a year earlier) would amount to 192 million pounds, 357 million pounds, and 414 million pounds respectively.



USDA's Foreign Agricultural Service is projecting an increase in total Chinese pork imports of 2.25 billion pounds this year. That would be an average monthly increase of 188 million. If U.S. suppliers were to garner 50% of that additional volume (considerably more than their current share of the Chinese market), then the year-over-year increase in U.S. shipments to China would amount to 94 million pounds per month. My projections from April through September imply an average monthly increase of 107 million pounds….fairly close, if not a little ambitious.

Next is the particularly wide-open question of domestic pork demand at the wholesale level. The next graph shows the demand index values that I am inserting into the equation. Demand has exploded, partly because of the groundwork that was laid via extraordinarily cheap prices in January and February, and of course, largely because of the rush among buyers to lock up product after China actually stepped up and started placing orders. As the graph shows, I am assuming that demand has shifted into a higher tier, similar to that which happened in 2014. Only there are some important differences between the current situation and 2014. At that time, the outbreak of Porcine Epidemic Diarreah greatly reduced the hog supply--a brand new phenomenon--and the market really did not know how to respond, partly because no one knew how much the supply would be reduced.

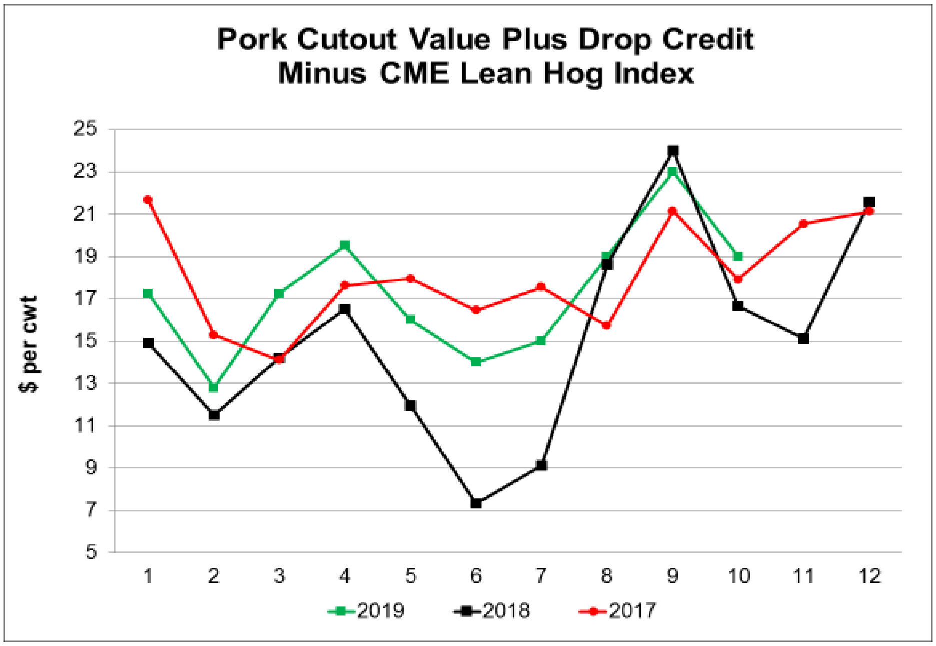


In contrast, this is a demand-led rally, and although no one knows how much pork China will wind up buying, at least we are dealing with a force with which we have dealt before. Buyers know how to respond: get covered, don't get caught short. Another important difference is that the force that that is driving this market upward has been long anticipated. If it makes any sense, this is why I doubt that domestic wholesale pork demand will achieve the heights that it did in 2014, when the market was caught off-guard.

Combining the hog slaughter projections that are indicated by USDA's most recent farrowing/pig crop estimates with the export volumes and demand index values shown above, I come up with the cutout values shown in the table at the end of this report.

The final picture shows the gross packer margins that I am inserting into the equation. The only point I would like to make on this subject is this: since this is a demand-led rally accompanied by bigger hog supplies, packer margins should remain wider than they were in 2018, even though slaughter capacity has expanded. Largely for this reason, it is probably errant to assume that the CME Lean Hog Index will be able to match its 2014 peak ($134.19). Applying the gross packer margins shown in the picture below suggests a high monthly average CME Index of about $91, that occurring in July.

What am I missing?



Forecasts:

	Apr	May*	Jun	Jul*	Aug	Sep*
Avg Weekly Hog Sltr	2,407,000	2,324,000	2,287,000	2,242,000	2,457,000	2,516,000
Year Ago	2,370,400	2,258,700	2,220,400	2,160,700	2,423,700	2,359,000
Avg Weekly Barrow & Gilt Sltr	2,340,000	2,260,000	2,220,000	2,180,000	2,390,000	2,450,000
Year Ago	2,304,900	2,195,200	2,154,700	2,099,000	2,358,200	2,294,600
Avg Weekly Sow Sltr	59,000	57,000	59,000	55,000	59,000	58,000
Year Ago	58,500	56,600	58,400	54,700	58,100	56,500
Cutout Value	$89.50	$92.50	$95.50	$100.50	$98.50	$90.00
Year Ago	$68.08	$73.59	$83.18	$82.70	$69.05	$74.33
CME Lean Hog Index	$74.50	$81.50	$86.50	$91.00	$84.50	$72.00
Year Ago	$56.47	$66.77	$81.13	$78.73	$55.46	$55.31

**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.