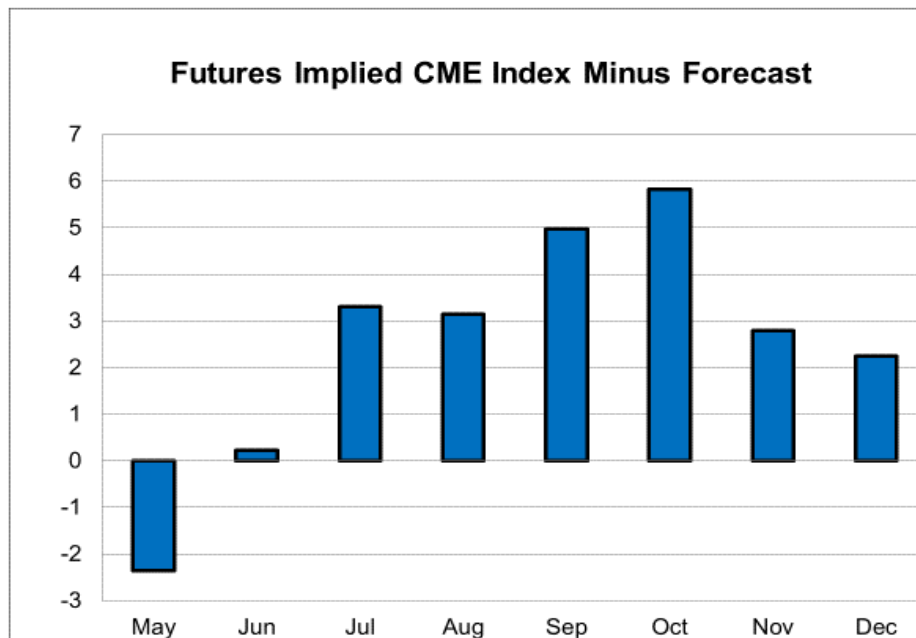


Trading Hogs

.... from a meat market perspective

A commentary by Kevin Bost

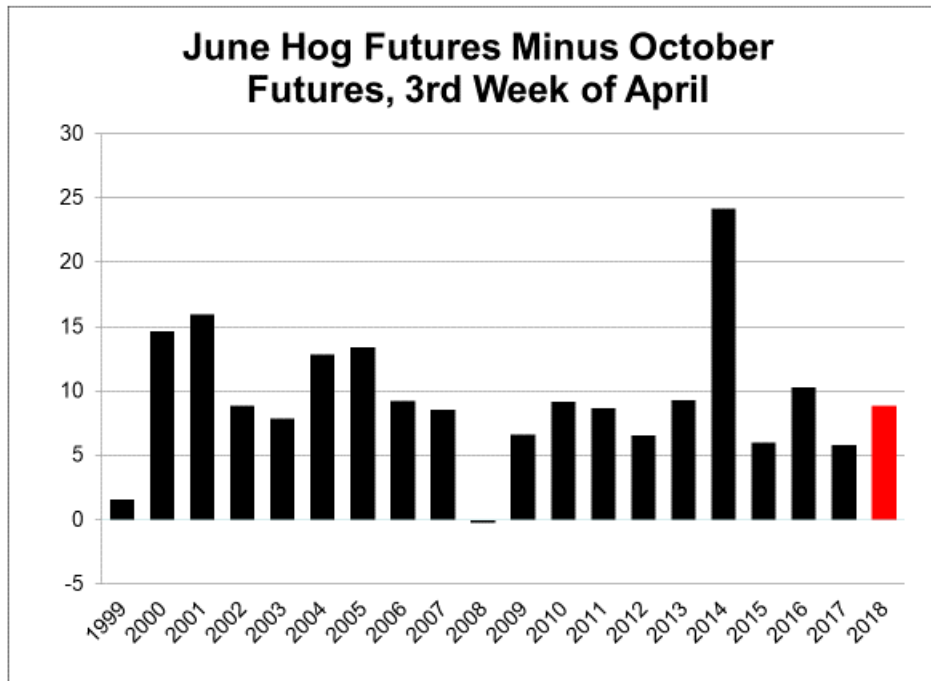
April 18, 2018



I have no money on the table in the hog market at the moment, but my attention is naturally drawn to the prospects of the June/October spread. Otherwise, there does not appear to be a fundamentally justified trading opportunity in the hog market.

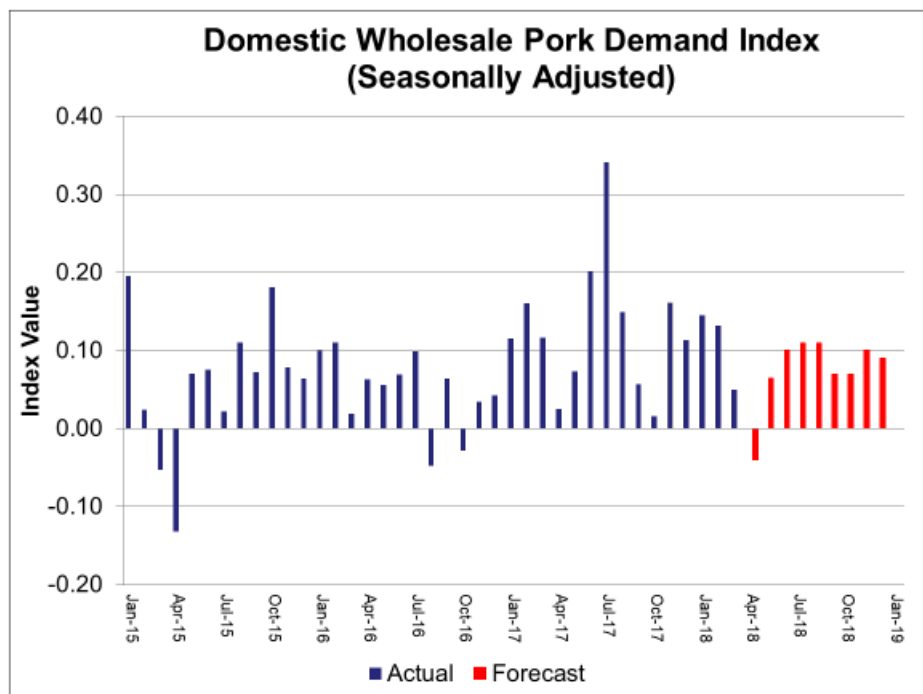
OK, so about that June/October spread.... first, a look at the *Daily Racing Form* to examine the current condition and past performances of this horse. At yesterday's close, the premium in the June contract stood at \$8.82 per cwt which, as you can see in the picture on the next page, is neither wide nor narrow by historical standards (the 15-year average is \$9.21). Going back to 1999—when the carcass weight-based futures contract came into existence—there is, on average, no distinct seasonal tendency for this spread to move in either direction from this point to the second week of June. However, I notice that in five of the last six years the June premium wound up at a minimum of \$10 by the expiration date; and in four of those years it finished between \$11.50 and \$16.50. And so, the most recent outings are somewhat auspicious.

The chart of the June/October spread appears to have formed a bottom, with major support in the \$8.00-\$8.60 range, clearly marking a spot for a stop-loss (which would be a close below \$7.75). I do not sense any need for urgency in entering this position; this is partly because I suspect that the spread would “blast off” only if there were to be a sharp and extended rally in the June contract—which seems a doubtful prospect, since the June contract appears to have already priced in as much of a seasonal rally in the cash market as we can readily expect. However, there is a gap on the daily chart of June hogs at \$79.85 which is likely to be filled. Thus, I plan to enter around \$8.50. [It trades at \$9.25 this morning.] The upside objective would be around \$12.00.



I am considering an outright short position in the October contract, but I'm not in a hurry to make this bet, either. The CME Lean Hog Index, which I am guessing to be very close to \$56 for today's kill, probably will march upward nearly every

day from now until Memorial Day. I am hesitant to be short of any hog contract while this rally lies ahead. After all, none of us knows just yet how far the rally in the cash market could carry. We are still very early in the game. Pork prices, especially loins, bellies, and hams, have been subdued long enough to build a base for a strong rebound in demand at the wholesale level, following an exceptionally weak month of April. In the picture below, April 2018 is represented by the first red bar. The rest are my humble projections.



My assumption regarding demand is that the seasonally adjusted demand index will return almost to its January-February reading by June. When I combine this index value with an average weekly kill of 2,278,000 in June, I come

up with an average cutout value of \$84.75 per cwt for that month. And when I apply a gross packer margin of \$13 per cwt vs. \$18 today and \$16.46 in June 2017, the calculation yields a June average CME Index of \$76.50. If the demand index were to fully match its most recent peak, which occurred in January, then the cutout value forecast would be raised to \$88 in June, and the CME Index forecast to \$80.

In any case, the June contract will “overdo it” to the upside before it’s all over, especially since the short position among large speculators has swelled to 14% of total open interest, its biggest share since November 2016. There is plenty of short-covering capacity in the hog market.

Forecasts:

	May*	Jun	Jul*	Aug	Sep*	Oct
Avg Weekly Hog Sltr	2,332,000	2,278,000	2,296,000	2,397,000	2,535,000	2,581,000
Year Ago	2,250,200	2,183,400	2,211,300	2,304,600	2,494,800	2,503,700
Avg Weekly Barrow & Gilt Sltr	2,265,000	2,210,000	2,230,000	2,330,000	2,465,000	2,510,000
Year Ago	2,185,200	2,117,200	2,149,300	2,241,600	2,429,000	2,436,800
Avg Weekly Sow Sltr	60,000	61,000	59,000	59,000	62,000	63,000
Year Ago	57,900	58,800	55,000	55,500	57,800	59,300
Cutout Value	\$79.00	\$84.75	\$84.00	\$85.00	\$77.50	\$75.50
Year Ago	\$84.92	\$97.04	\$103.48	\$91.67	\$77.89	\$74.51
CME Lean Hog Index	\$70.25	\$76.50	\$76.00	\$76.00	\$64.50	\$62.00
Year Ago	\$72.28	\$86.09	\$91.47	\$81.41	\$62.02	\$61.73

**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.

Information herein is derived from sources believed to be reliable, with no guarantee to its accuracy or completeness. Opinions expressed are subject to change without notice. Each investor must consider whether this is a suitable investment. All funds committed should be risk capital. Past performance is not necessarily indicative of future results.