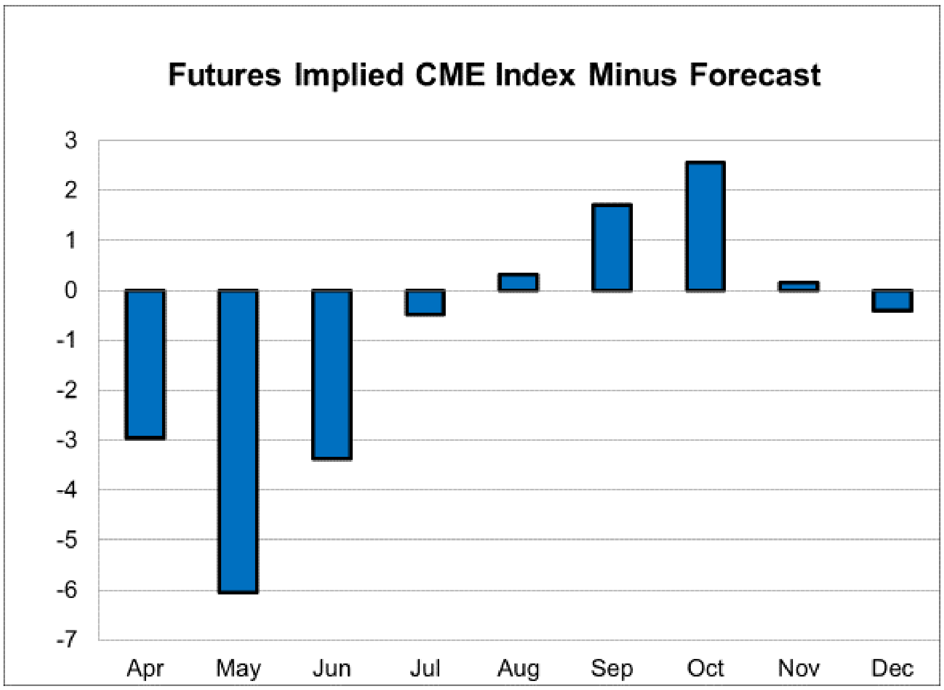
Trading Hogs
…. from a meat market perspective
A commentary by Kevin Bost

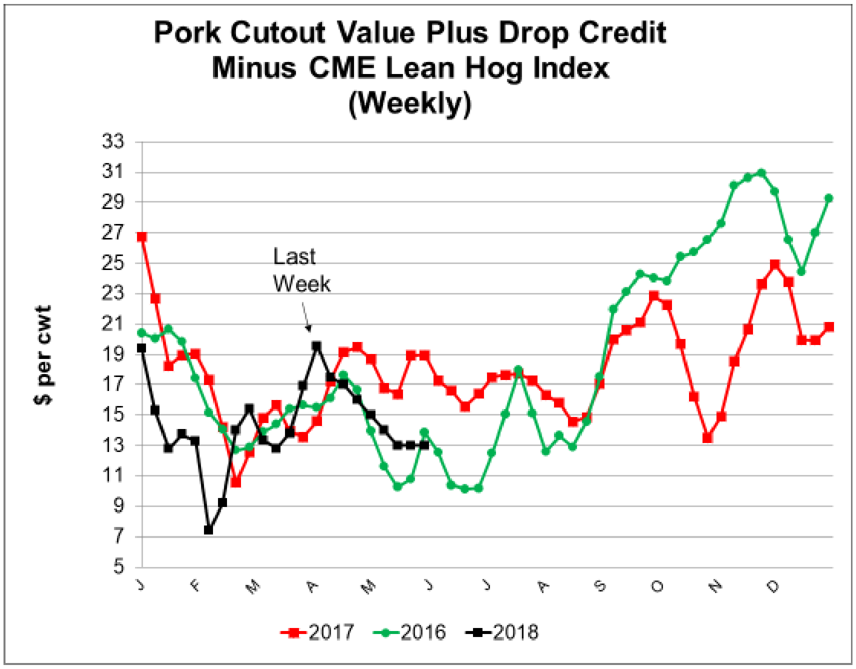
April 9, 2018



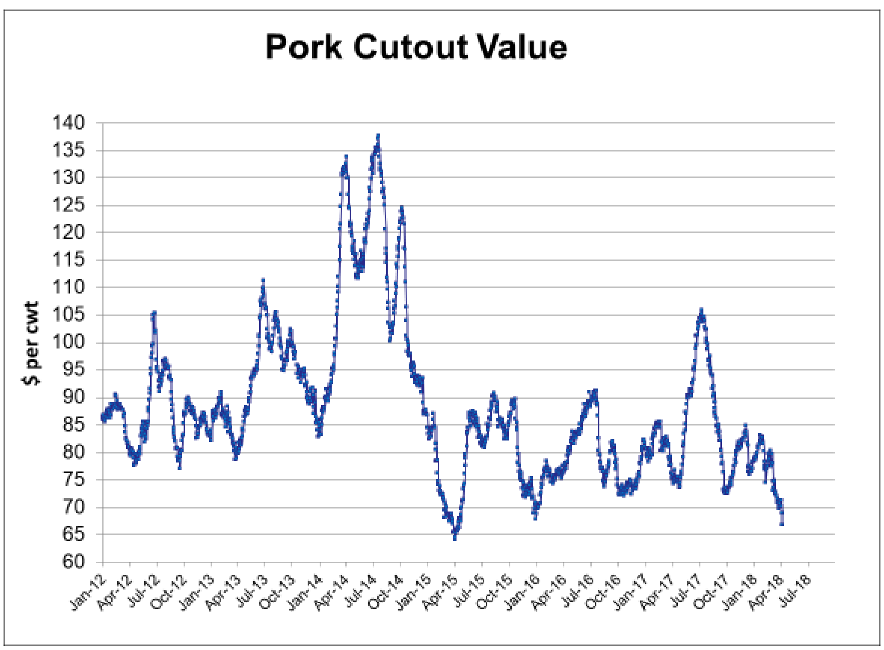
The CME Lean Hog Index has fallen quite a bit farther than I had expected, and it was still losing ground as last week came to a close. But let's face it: if it's not on bottom right now, it's *very* close. From here, it probably will put together a long string of daily gains. This consideration, along with the picture above, mandates that I trade the front end of the hog market only from the long side. I am opting for the June contract, for obvious reasons. The April contract may be equally undervalued, but *only* if the cash market does an immediate about-face. I don't want to bet on that happening.

The factor in the equation that has "short-circuited" is the packer margin. The quoted gross packer margin—the cutout value plus the byproduct value minus the CME Lean Hog Index—has ballooned $6 per cwt just within the last two weeks. As I show in the picture on the next page, this past week's average was $5 wider than a year ago and about the same as it was in the middle of November. Apart from the Man Behind the Curtain pulling levers to make sure that I lose money trading hog futures, I have to think that this was brought about by temporary factors; and that packer margions will shrink almost as quickly as they widened. After, all, we are still working with significantly greater slaughter capacity, aren't we? Anyway, there is plenty of room for the cash hog market to appreciate even if the cutout value does not.

My best guess is that quoted gross margins will average about $13 per cwt in June, which is roughly halfway between the June 2017 reading and the five-year average. [Last June they averaged $16.46.] Naturally, this is the factor in which I have to least amount of confidence right now. But I think it's fair to say that a packer margin of $16.50 in June would be at the bearish end of possibilities, while $11 would be at the bullish end (in terms of the cash hog market, that is).



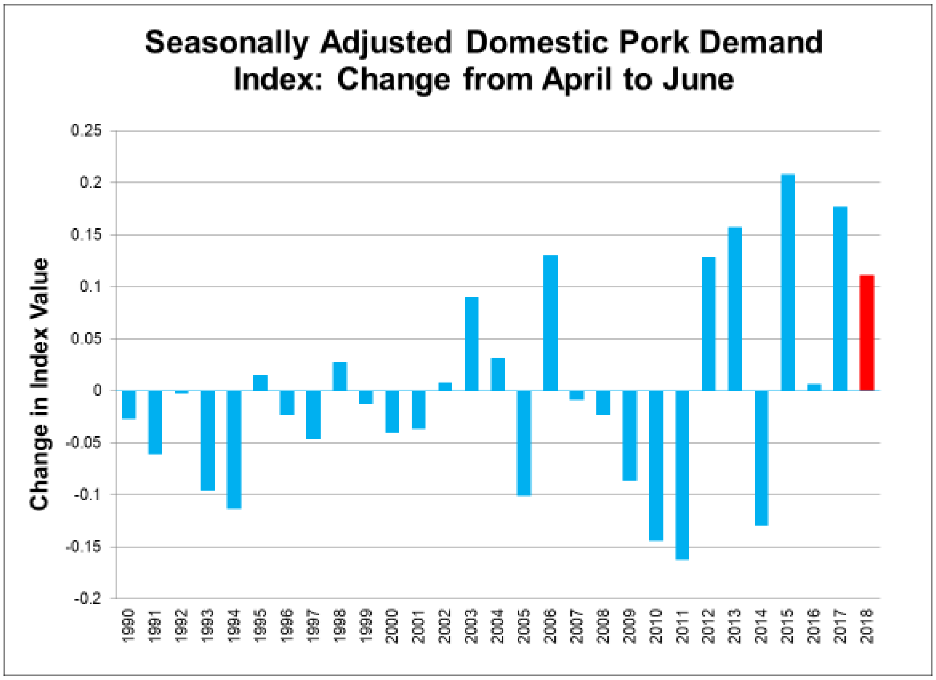
The cutout value, meanwhile, fell hard last Thursday and Friday, to its lowest level since Aptil 1, 2015. While significant, I do not regard this as a harbinger of a sustain downtrend from this point, one reason being that there is major support on this chart at $65 per cwt (Friday's quote was $66.69); the other is that bellies are now situated around $.90 per pound, a level at which they are likely to attract storage demand. Belly prices are doing what they need to do in order to build bacon demand for the summer; they have now spent four weeks essentially below $1.05. Loin prices are also cheap, to say the least.



Given the very weak demand readings that are taking shape here in April, it's likely that there will be a stronger-than-seasonally-normal change in demand between now and April. Also, I consider that retail pork margins are quite wide, and retail prices are moving downward. In the final picture I show you my humble expectation of the April-to-June change. Combining this change in demand with an average weekly kill of

2,278,000 yields an average cutout value of about $84.50 per cwt in June. There is obviously important resistance on the chart above between $85 and $90.

OK, so if I apply the more bullish packer margin ($11.00 per cwt) to an $84.50 cutout value, I come up with an average CME Index of $78.50; the more bearish packer margin ($16.50) would place the Index at $73.00. The moderate packer margin of $13 aligns with an Index of $76.50, which is the price against which the board is compared in the graph on the first page.



The June contract may have made its low last Wednesday at $70.25, but I am not thoroughly convinced of it. This market has yet to break through its ten-day moving average. I notice that Wednesday's big outside range/reversal, which ranged from $70.25 to $73.77, was followed by a close above that range on Thursday, and then a close back within that range on Friday. According to the textbook, this signals a return to the $70.25 neighborhood. Depending on how the market performs in that price range, I am willing to buy June hogs on such a test. I cannot complete my trading plan without mentioning gaps on the daily chart, and in the June contract there are three: one at $75.47, which is very likely to be filled; another at $79.85, which has a decent chance of being filled; and a third at $81.92, which the fundamentals suggest will remain open unless the board becomes substantially overvalued once again….

Forecasts:

	Apr	May*	Jun	Jul*	Aug	Sep*
Avg Weekly Hog Sltr	2,353,000	2,332,000	2,278,000	2,296,000	2,397,000	2,535,000
Year Ago	2,285,400	2,250,200	2,183,400	2,211,300	2,304,600	2,494,800
Avg Weekly Barrow & Gilt Sltr	2,287,000	2,265,000	2,210,000	2,230,000	2,330,000	2,465,000
Year Ago	2,220,200	2,185,200	2,117,200	2,149,300	2,241,600	2,429,000
Avg Weekly Sow Sltr	59,000	60,000	61,000	59,000	59,000	62,000
Year Ago	58,100	57,900	58,800	55,000	55,500	57,800
Cutout Value	$70.75	$79.50	$84.75	$84.00	$85.00	$77.50
Year Ago	$74.86	$84.92	$97.04	$103.48	$91.67	$77.89
CME Lean Hog Index	$58.00	$70.50	$76.50	$76.00	$76.00	$64.50
Year Ago	$62.60	$72.28	$86.09	$91.47	$81.41	$62.02

**Slaughter projections exclude holiday-shortened weeks*

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