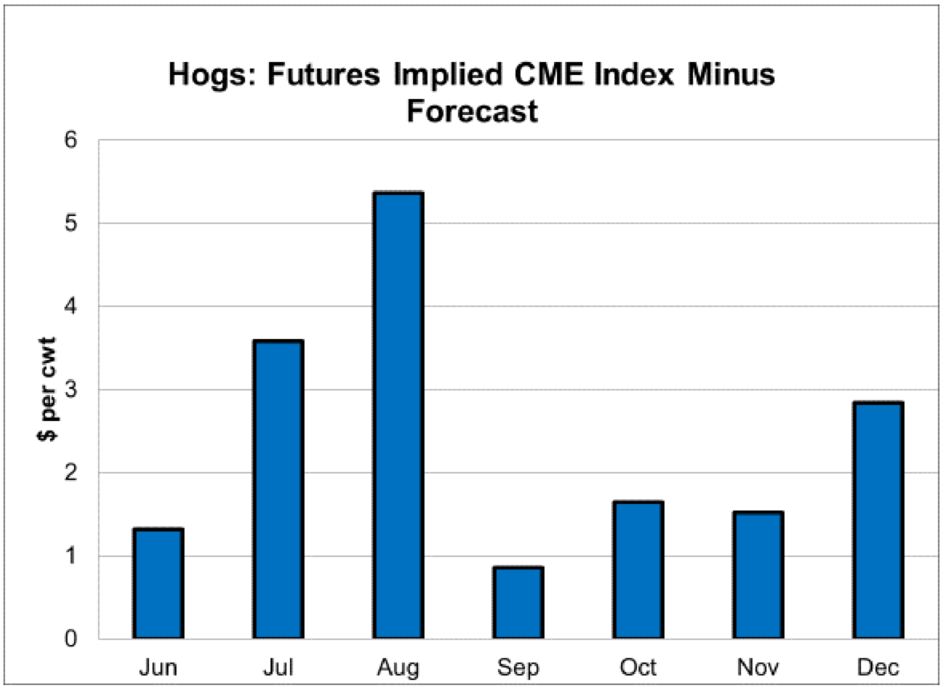
Trading Hogs
…. from a meat market perspective
A commentary by Kevin Bost

May 10, 2018



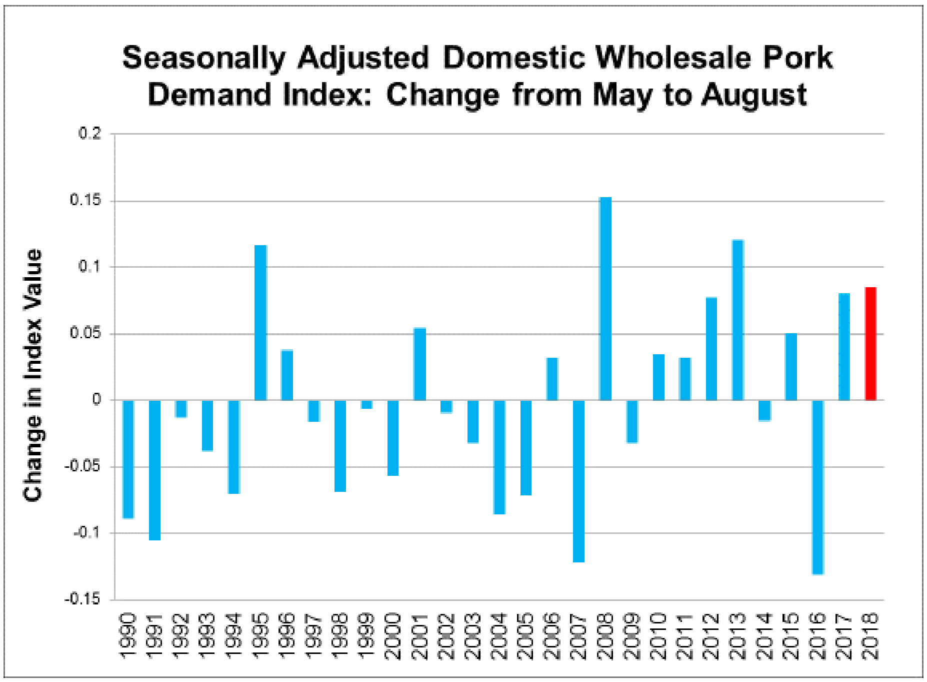
I exited my long June / short October spread yesterday, and I have no other bets on the table a this time. It's looking more and more likely, though, that my next move will be an outright short position in the August contract and/or a short position in the June $80 calls.

Before I get too excited about selling into the hog market, though, I have to keep two things prominently in mind. One is that the composition of the market makes it vulnerable to a wave of short-covering: as of last Tuesday, speculative shorts comprised nearly 14% of the total "pie", the largest share since November 2016; the commercial short position (20%) is the smallest since November 2016, while the commerical long position (11%) is the largest in more than three years. Overall, I interpret this as a bullish condition that can only be mitigated by a significant rally. The other is that the current trend in the cash hog market is obviously upward. As you probably know by now, I am always hesitiant to trade a market from the short side when the cash market is advancing.

My guess is that the seasonal peak in the CME Lean Hog Index will be close to the February peak of $75.66 per cwt. My Honest-to-God-Best-Guess forecast of the June average is $75.25, which would leave room for the Index to poke above $75.66, but not by much--$78 is my "pinpoint" projection. The Index value for today's kill appears to be about $64.25. A rally to $78 in the fourth week of June would make for a 21% increase between now and then, compared with the 15-year average appreciation of 7% over the same time period.

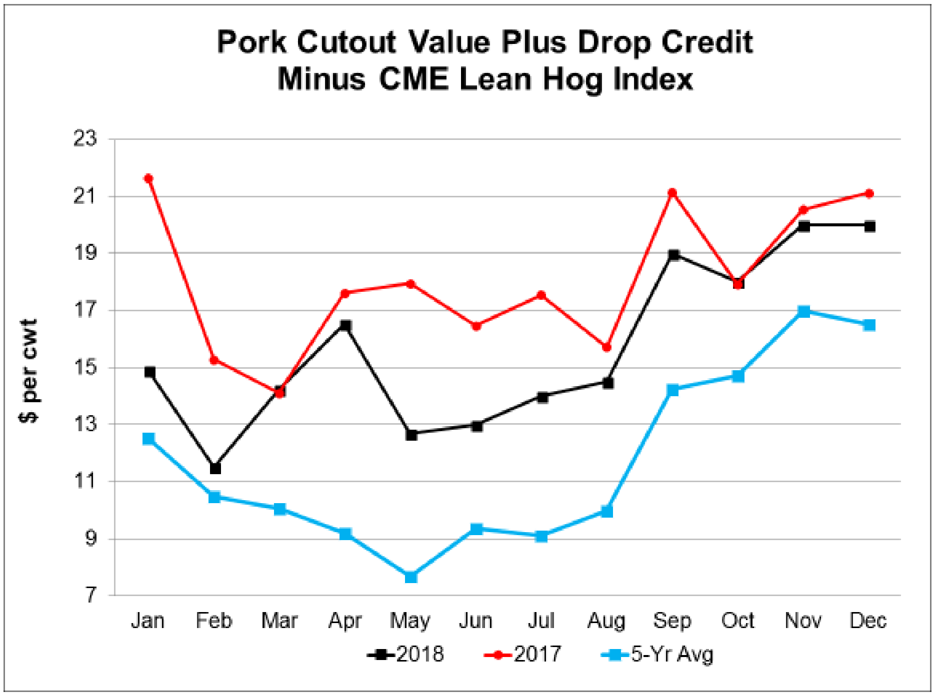
The July contract shows a gap on the daily chart at $79.87. In light of the market composition conditions that I just described, this price seems within reach. My plan at the moment is to sell August hogs if this gap is filled. If the July/August spread were to remain at its current standing, then the August contract would trade just above $79.50 at that time. That would present a profit opportunity of about 750 points.

You might have noticed that I have lowered my cash market forecasts since my last report. This is mainly because of the weaker-than-expected performance of wholesale pork demand over the last seven weeks. Still, my forecast of an $81.50 average cutout value in August assumes a considerably stronger-than-seasonally-normal change in demand between May and August, as I show below. A perfectly average seasonal change would be represented by a zero value in this picture:



Why do I assume so? Only because of the good possibility that a sustained period of relatively low prices, such as we have experienced for the better part of two months now, will eventually "buy back" some demand. My forecast of U.S. pork exports in the June-August period, by the way, is up 4.5% from a year earlier, averaging 438 million pounds per month. Combined with the slaughter projections shown below and carcass weights that are 1.6 pounds heavier, net domestic per capita supplies should be 6% larger than a year earlier in August.

With an average cutout value of $81.50 in August, the next step is to project the spread between the cutout value and the CME Lean Hog Index. This picture is shown on the next page. Today's quoted gross packer margin stands at $13 per cwt. You can probably tell that my projection is guided by the five-year average and the 2017 readings. The influence of additional slaughter capacity is quite evident; although margins acted oddly in March and April—I still don't understand why—they have generally been significantly narrower than a year earlier since last fall. I am factoring in a gross margin of $14.50 in August vs. $15.72 in August 2017. Maybe this is too wide, considering that margins currently are almost $4 narrower than at this point last year; but I also consider that in August 2017 they made an unusual move downward. OK, so let's say that margins wind up at $13 instead of $14.50; in that case, my August forecast of the CME Index would be raised to $73.50.



As for the June $80 calls, the case for a short sale should have been explained by the reasoning presented above. This morning they trade near $1.00 per cwt as the June contract trades near $77.00. The $78 calls, which are $1.00 "out of the money", trade at $1.65 per cwt. This leads me to think that if the June futures contract were to reach $79 within the next few days, then the $80 calls could be sold for $1.50. This, then, is my targeted entry point.

Forecasts:

	May*	Jun	Jul*	Aug	Sep*	Oct
Avg Weekly Hog Sltr	2,264,000	2,264,000	2,216,000	2,397,000	2,480,000	2,581,000
Year Ago	2,196,100	2,183,400	2,127,700	2,304,600	2,420,500	2,503,700
Avg Weekly Barrow & Gilt Sltr	2,197,000	2,195,000	2,150,000	2,330,000	2,410,000	2,510,000
Year Ago	2,133,800	2,117,200	2,068,800	2,241,600	2,357,500	2,436,800
Avg Weekly Sow Sltr	60,000	62,000	59,000	59,000	62,000	63,000
Year Ago	55,300	58,800	52,100	55,500	55,500	59,300
Cutout Value	$75.00	$83.25	$83.00	$81.50	$78.50	$75.00
Year Ago	$84.92	$97.04	$103.48	$91.67	$77.89	$74.51
CME Lean Hog Index	$67.50	$75.25	$74.00	$72.00	$64.00	$62.00
Year Ago	$72.28	$86.09	$91.47	$81.41	$62.02	$61.73

**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.