

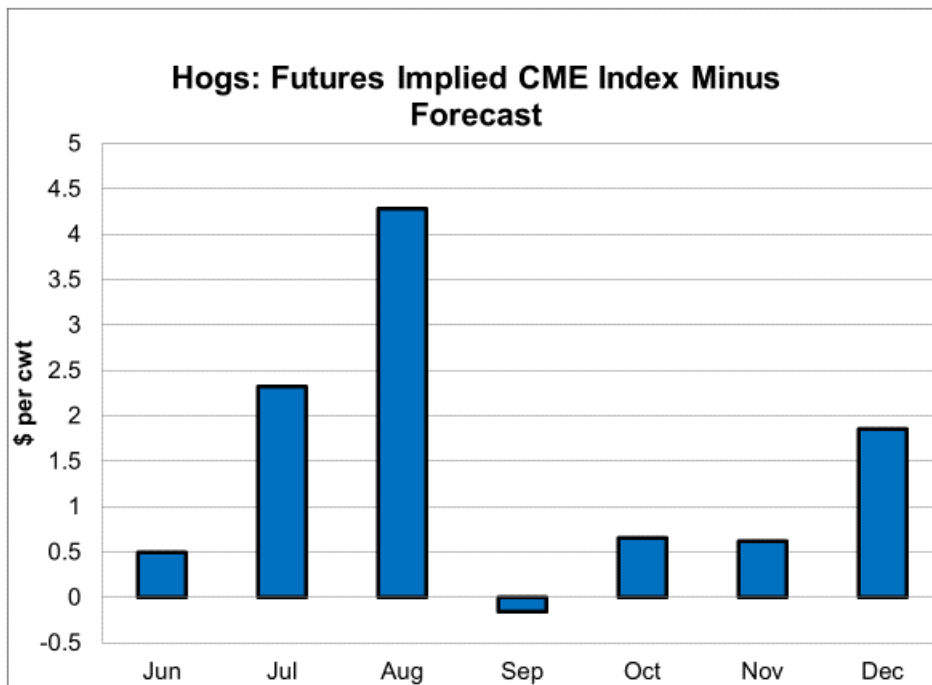
# Trading Hogs

## .... from a meat market perspective

A commentary by Kevin Bost

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May 18, 2018



I have no money riding on the hog market at the moment. My plan, though is to sell the August contract as closely to \$80 per cwt as I possibly can. This one is not wildly overvalued as of this morning, but it appears to be worth roughly \$73. The obvious place for a

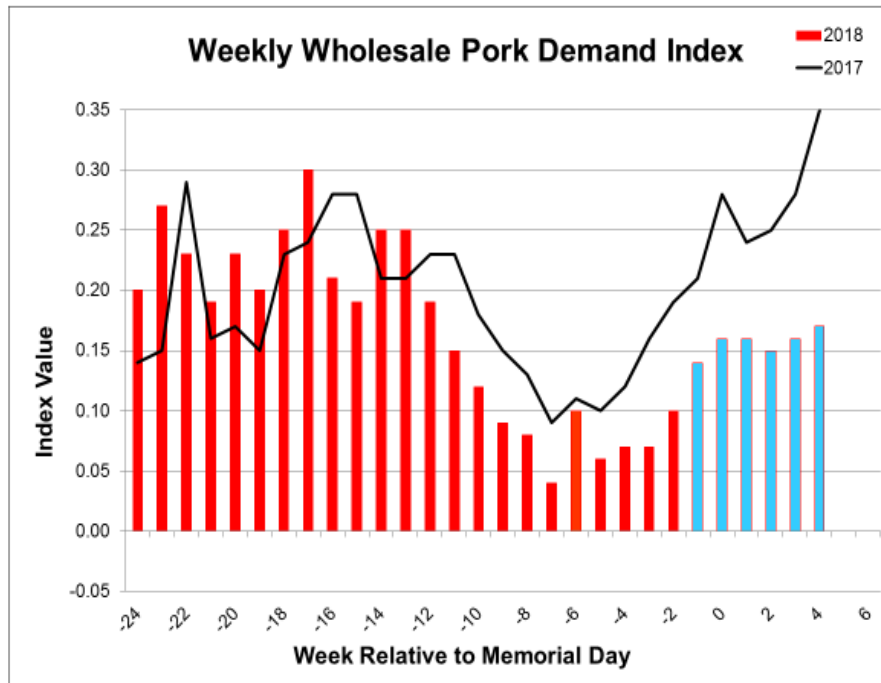
stop-loss would be a close above \$81.32, thus a sale at \$79.50 would present a profit potential of 650 points and a risk of about 200....an acceptable proposition in my book.

An appreciable round of short-covering on the board seems likely, partly because the speculative community is heavily short, and partly because there is a gap on the daily chart of July hogs at \$79.87. If the July contract closes above \$78.87, it will leave nothing in the way of resistance below that gap. I suspect that if that were to happen, then the August contract would be trading about \$1.00 per cwt below the July; in that case, an \$80 trade in July hogs would bring the August up to only \$79.00, which is the approximate location of a major downtrend line. But it seems too tidy a scenario for July hogs to rally to \$80, top out, and turn back down from there. I point once again to the massive short position among large speculators which, as a percentage of total open interest, is the largest since October 2016 and very close to an eight and a half-year high.

Much like myself, the pork market is underperforming relative to my expectations. There is further upside potential, of course, but it's looking more and more likely that the practical peak in the cutout value will be \$85 per cwt....and even *that* assumes a substantially stronger-than-normal change in demand from May to June and all the summer months. It is a bit startling to realize that if the wholesale pork market were to undergo merely typical seasonal changes from

this point forward; and if hog slaughter proceeds at the rates shown in the table below; then the pork cutout value would average only \$77 per cwt in June and July, and \$74.50 in August. Those figures would probably align with a CME Lean Hog Index of \$68.50 in June; \$67.50 in July; and \$66.50 in August. Wow. The prices seem ridiculously low, but hey—in the academic world, this would be the most objective forecast, since it is a straightforward projection from the current condition.

Intuitively, it seems much more likely that wholesale pork demand will *outperform* the seasonal norm from the rather dismal readings here in May. In the picture below, the blue bars represent my humble forecast for the fourth week of May through the final week of June:



I am willing to bet on some degree of “outperformance” in demand, simply because prices—mainly hams and loins—have been incredibly cheap for an extended period of time. This situation usually lays the foundation for an increase in demand, although it’s difficult to predict how long that will take. Anyway, average retail pork prices are

low and declining, and retail margins are fairly wide (with the exception of pork butts and spareribs). Thus, pork should continue to be prominently featured through June, if not farther out into the summer.

Finally, I notice that over the last 15 years, the average change in the CME Lean Hog Index between the current week and the June-July peak is +\$6.30 per cwt; this week’s average will wind up at about \$67.35. You can do the math.

I am more than just a little bit interested in the short August/long October spread, which has made new highs this week and this morning trades at an August premium of \$13.75 per cwt. I approach this strategy as an alternative to an outright short August position, though, and will place a bet on it if I am unable to get the August contract sold at an acceptable risk: reward ratio.

Forecasts:

	May*	Jun	Jul*	Aug	Sep*	Oct
Avg Weekly Hog Sltr	2,266,000	2,277,000	2,213,000	2,396,000	2,478,000	2,579,000
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	2,203,000	2,210,000	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	56,000	60,000	56,000	58,000	60,000	61,000
Year Ago	55,300	58,800	52,100	55,500	55,500	59,300
Cutout Value	\$75.00	\$82.50	\$83.75	\$81.50	\$78.50	\$75.50
Year Ago	\$84.92	\$97.04	\$103.48	\$91.67	\$77.89	\$74.51
CME Lean Hog Index	\$67.50	\$74.50	\$75.00	\$72.50	\$64.50	\$62.00
Year Ago	\$72.28	\$86.09	\$91.47	\$81.41	\$62.02	\$61.73

*\*Slaughter projections include holiday-shortened weeks*

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