

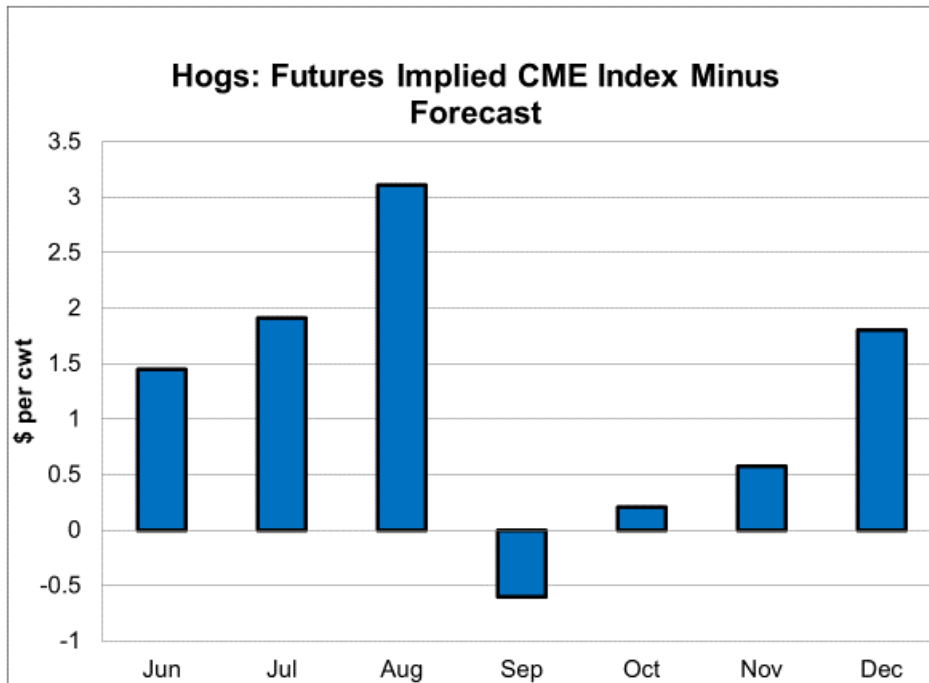
# Trading Hogs

## .... from a meat market perspective

A commentary by Kevin Bost

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May 24, 2018



Last week I said that I was interested in the short August / long October spread, which I would execute when it became evident that I was not going to be able to sell August hogs outright with an acceptable risk: reward ratio. Well, that evidence surfaced on

Tuesday, when the August contract closed below a major support level of \$75.12—leaving no obstacle on the path to its contract low of \$72.45. The only meaningful place for a stop-loss trigger was/is \$78.50, which precluded an outright sale at Tuesday's close.

And so, I am now short of the August contract and long of the October contract, with an objective of somewhere between \$10 and \$11 premium to the August; I am risking the trade up to a close above the contract high of \$14.27. As you might have guessed, the objective is derived from the chart above, along with the fact that the August premium traded as low as \$9.95 seven weeks ago.

Now, I am aware that even if the ultimate values of the two contracts may indeed be only \$10 apart, as I show in the table below, this doesn't necessarily mean that the futures spread will narrow to \$10 before the August contract expires. And I am aware of the talk about possible disease-related supply reductions this summer. When I begin to see evidence that the winter pig crop is not as big as USDA reported in March, then I will sit up and pay attention....and respond accordingly. But the greatest threat to a bear spread would be a sharp rally in the cash market....which seems an unlikely prospect, given the market's current behavior.

My best guess at this point is that the August contract is ultimately worth somewhere between \$72 and \$73 per cwt. This forecast assumes that the changes in wholesale pork demand between now and June, July, and August will be considerably stronger than the seasonal norm, because prices of most major products have been surprisingly cheap for an extended period of time; and yet, I still come up with average cutout values of \$82 per cwt in June; \$84 in July; and \$81.50 in August. [The cutout value this afternoon was quoted at \$74.11.] I am also assuming that gross packer margins (currently \$11.50 per cwt) will average \$13 in June vs. \$16.46 a year earlier; \$13.75 in July vs. \$17.54 a year earlier; and \$14.50 in August vs. \$15.72 a year earlier. These assumptions point to a monthly average peak in the CME Index of \$75 in July. [I estimate today's Index value at \$69.40.] If, by some chance, pork demand were to merely undergo seasonally typical changes from this point forward, then we would be looking at a monthly average peak in the Index below \$70, and probably in June. So it is conceivable that my cash hog market forecasts are too high.

### August Hogs minus October Hogs



Anyway, I am deploying my relatively tight stop loss to guard against such bullish contingencies. I must say that I am encouraged that the price action at the peak of the August/October spread last Wednesday was almost the mirror image of that which occurred when the spread bottomed on April 4: it took out the contract high; "hooked back"; and promptly sold off nearly 200 points.

Finally, it's worth noting that the August/October spread, at \$13.00, is rather wide by historical standards. Only once since 1999 has it been wider in the fourth week of May, and that was in 2014, in the midst of a charging bull market. Over the last 15 years, the average August premium at this point on the calendar is \$9.33.

Forecasts:

	May*	Jun	Jul*	Aug	Sep*	Oct
Avg Weekly Hog Sltr	2,271,000	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	2,208,000	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	57,000	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	\$74.00	\$82.00	\$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	\$66.50	\$74.00	\$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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