

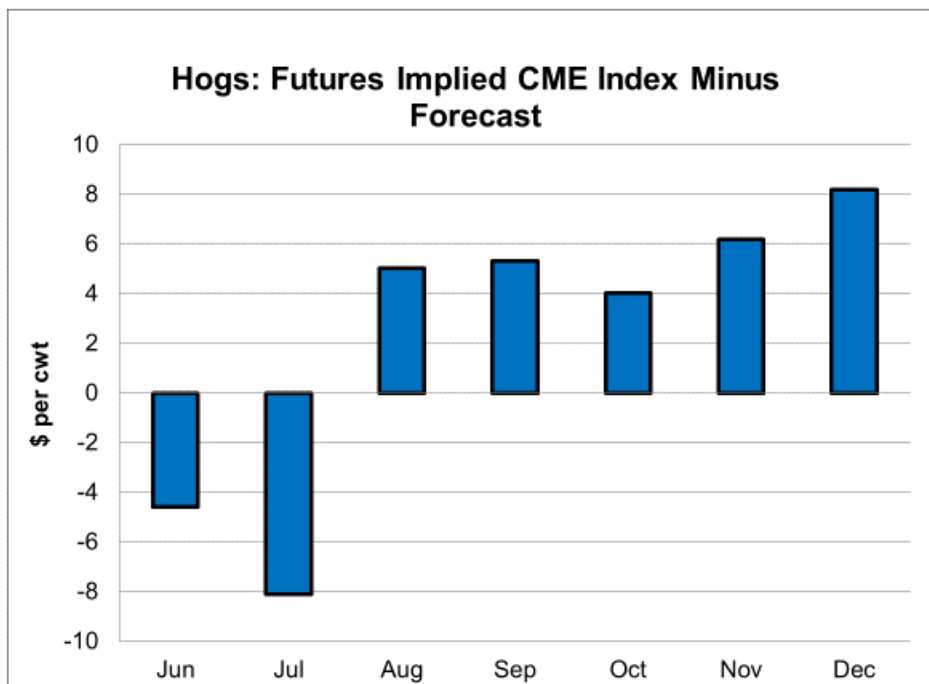
# Trading Hogs

## .... from a meat market perspective

A commentary by Kevin Bost

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May 27, 2019



I bought the July contract on Friday's limit-down move, exchanging one half of my short position in the June \$88 puts for the outright long. My plan had been to hold the June puts

until a better opportunity came along....and a long-side bet in July hogs at \$88 seems to qualify.

The July contract has placed itself in a technically vulnerable position; the \$88.00 area is obviously an important support level on the daily chart, and if it gives way in a decisive manner, then the downside objective would become approximately \$84.85. [I am measuring from the high of May 2 (\$97.22) to the low of May 13 (\$87.75), and assuming a duplication of that move from last Monday's high of \$94.32....does this make sense?] I am prepared to risk 300 points on this trade, because the profit potential appears to be approximately 800 points. However, this amount of risk justifies only a modest position, which is why I did not go "all-in" on this exchange. I will consider doing so if the July contract drops to \$85.00.

But unless my assessments of "fair value" are way off the mark, the timing of a long-side bet seems right. The premium of the July contract over the CME Lean

Hog Index has come down from \$11.00 per cwt at the beginning of the month to \$4.75--which is still wide compared with the longer-term history, but not the more recent history. Last year it averaged \$8.66 in the final week of May, and the year before it was \$4.70. What really matters, of course, is the direction of the cash market from this point forward.

There is a good chance that the pork cutout value will make a strong move upward over the next four to five weeks. According to USDA's pig crop estimates, hog slaughter should average about 2,275,000 per week in June, down 50,000 head from this past week's total. This by itself is nothing special, but there are two considerations that make this year a little different: one is that an additional 60,000 hogs per week will be diverted into carcass production and thereby siphoned away from the domestic market in June, exacerbating the supply reduction (or so I hear, anyway); the second is that normally, the cutout value rallies strongly during the month of May, and this year it was flat. Maybe this is completely irrelevant, but one might say that after a full month of consolidation, the market is poised for another leg upward. In any case, I don't think we'll have to wait very long to find out if my thesis is correct. If there is no material advance in the cash market this week, I will be unpleasantly surprised.

I realize that the spread between the CME Index and the cutout value is very narrow right now, and so cash hog prices will probably not be able to keep pace with pork prices. My forecasts assume that gross packer margins will expand from this past week's average of \$5.75 per cwt to \$9 in June and \$10 in July. This variable has been difficult to forecast lately, but I *think* that I am allowing it enough room. Margins have been below a year earlier for the past nine weeks, by an average of \$6.13 per cwt; and last year they averaged \$7.34 in June and \$9.12 in July.

I detect nothing in the market composition figures that would make the hog market susceptible to a "blowout"-type move in either direction. Both long and short positions held by managed money traders are relatively small, at 14.9% and 3.7% of the total reportable position respectively. The largest stakeholders (again, from an historical perspective) are commercial shorts (31.8%); managed money spreads (9.5%) and unclassified longs (8.1%). Presumably, the latter encompasses the large, individual spec traders.

Forecasts:

	May*	Jun	Jul*	Aug	Sep*	Oct
Avg Weekly Hog Sltr	2,292,000	2,277,000	2,247,000	2,462,000	2,521,000	2,615,000
Year Ago	2,258,700	2,220,400	2,160,700	2,423,700	2,359,000	2,550,000
Avg Weekly Barrow & Gilt Sltr	2,229,000	2,210,000	2,185,000	2,395,000	2,455,000	2,545,000
Year Ago	2,195,200	2,154,700	2,099,000	2,358,200	2,294,600	2,480,900
Avg Weekly Sow Sltr	56,000	59,000	55,000	59,000	58,000	62,000
Year Ago	56,600	58,400	54,700	58,100	56,500	61,100
Cutout Value	\$86.25	\$96.50	\$100.50	\$95.50	\$89.00	\$89.00
Year Ago	\$73.59	\$83.18	\$82.70	\$69.05	\$74.33	\$78.56
CME Lean Hog Index	\$84.50	\$93.00	\$96.00	\$84.50	\$73.00	\$77.50
Year Ago	\$66.77	\$81.13	\$78.73	\$55.46	\$55.31	\$66.89

*\*Slaughter projections include holiday-shortened weeks*

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