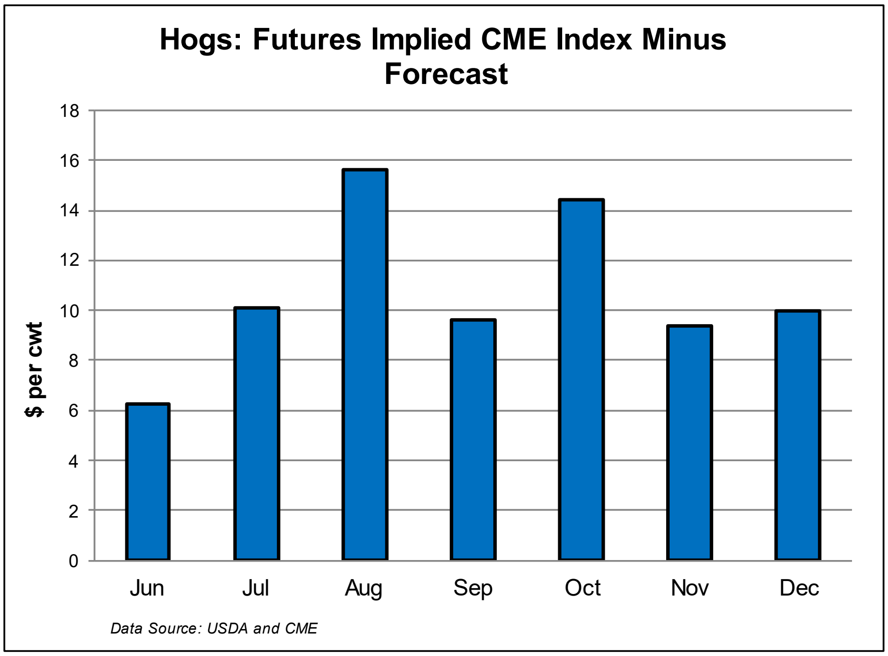
Trading Hogs
…. from a meat market perspective

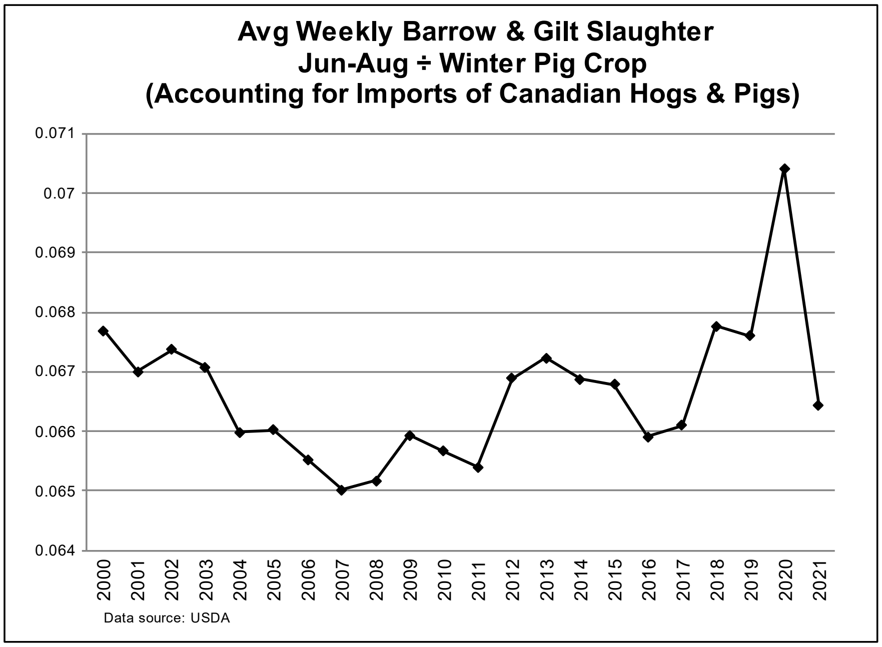
A commentary by Kevin Bost

May 31, 2021



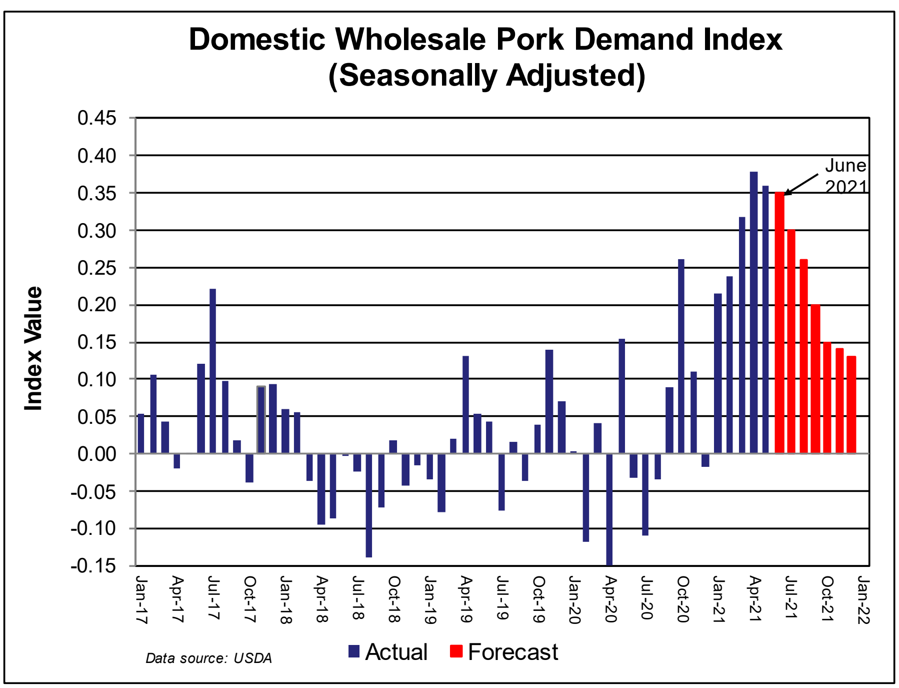
I hold no position in the hog market at the moment, but the board—the August and October contracts in particular—still appears to be vastly overvalued, even after factoring in some significant upward adjustments to the projections of wholesale pork demand. There is a lot of money to be made from the short side of this market, and so I will lay yet another bet on the table before long. What I have in mind is to sell August hogs either somewhere in the $119-$120 range (a duplication of the last major leg up would measure to $119.40), or upon a convincing signal that the pork cutout value is turning around. And what, pray tell, would constitute a convincing signal? At this stage of the game, it wouldn't take much of a downtick; but it would necessarily include a substantial drop in loins, butts, and spareribs, as these particular items would be the first to indicate that product movement is slowing down due to higher retail prices. The cutout value appeared to have topped out two weeks ago, when it traded sideways for four days, but that signal proved to be false. What is different now is that we are past the Memorial Day "push"….and the cutout is $10 higher than it was back then.

Before addressing the demand side of the equation, I should point out that the board trades as though hog supplies will be distinctly smaller than USDA's winter pig crop estimate suggests. Of course that's possible, but apart from the gossip columns, I have no reason to expect it. I am assuming that the ratio of June-August hog slaughter to the winter pig crop will fall into a normal range this time around.



Actually, the slaughter projections shown in the table at the end of this report would place them a shade below the ten-year average, excluding the 2020 outlier. If the winter pig crop was counted accurately, then last week's total of 2,356,000 will be the smallest that we will see in any non-holiday week from this point forward (for practical purposes, anyway). Given how high prices are right now, one would *think* that they would be sensitive to even a slight upturn in production.

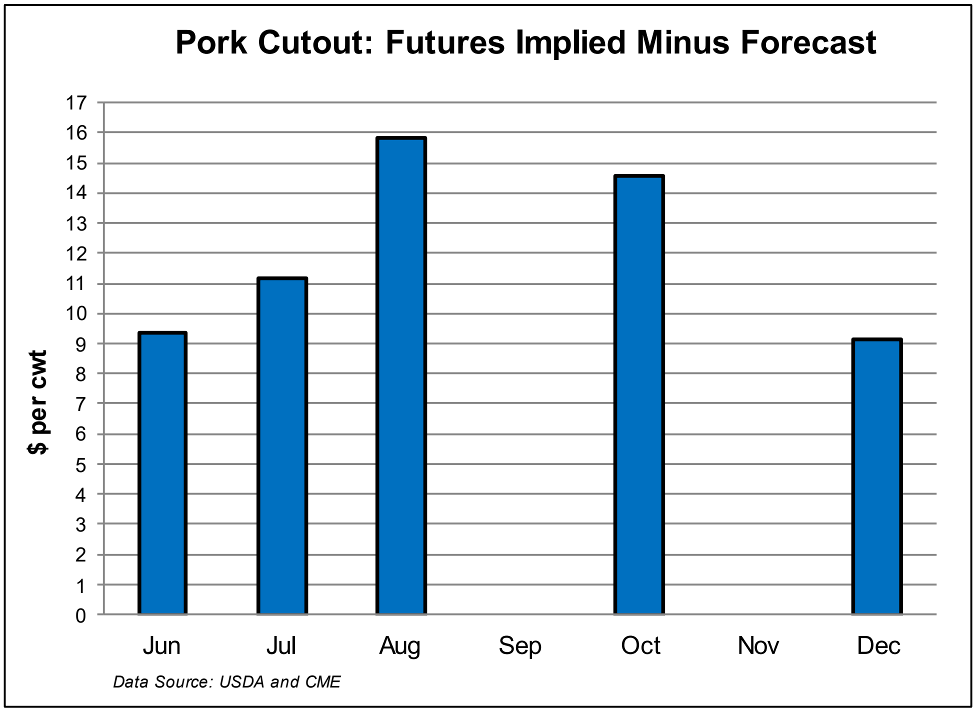
OK, so about those upward adjustments to the demand index? They are shown in the picture below:



In the wake of such a dramatic increase in wholesale product costs, there is certainly room for greater demand erosion than I am portraying here. But I am making these adjustments anyway, just because the pork market has fooled me up to this point. And yet, even if the seasonally adjusted demand index in June essentially matches its performance during May, then the cutout value will average near $118 per cwt in June—about $8 below the current quote. And even assuming that the index in August will match or exceed any single-month figure between October 2014 and March 2021, the cutout value would average “only” about $107 in August. If the gross packer margin index runs $2-3 per cwt above the 2012-2019 average through the summer, as it did in April and May, then the CME Lean Hog Index would average in the neighborhood of $110 per cwt in June and July, and near $99 in August. Obviously, the futures market is expecting something much better than that.

As this letter is being written, we are just now hearing about cyber attacks shutting down all JBS’ Australian meat works today. There is no official word at this time about whether or not JBS will halt its North American slaughter and processing operations as well; and if so, how long the shutdown might last. Obviously, if all JBS plants were to be down for several days or longer, it would have a bearish impact on cash hog prices. At the same time, reduced production would tend to boost pork prices, although the bearish effect on the former would probably outweigh the bullish effect on the latter….because other packers would temporarily increase kill schedules, labor constraints permitting.

There is another extraneous factor looming on the horizon that could be bearish of the hog market, and that is the potential reduction in slaughter capacity at the end of June. USDA last week declined to appeal a Minnesota court’s decision that would prevent plants from processing more than 1,106 hogs per hour. Currently there are six plants operating above that threshold: Guymon (Seaboard), Beardstown (JBS), Hatfield (Clemens), Coldwater (Clemens), Austin (Hormel), and Fremont (Wholestone). According to Dr. Dermot Hayes of Iowa State University, these six plants are running at paces of 1,225 to 1,450 per hour. At the bottom line, Dr. Hayes estimates that if this ruling remains intact, industry-wide capacity will be cut be 2.5%, or 80,000-100,000 per week. Naturally, the impact would be greater in the fall, though it would probably affect the summertime market to some degree. My gut feeling is that the July 1 implementation date will be delayed, but we’ll see.



Forecasts:

	Jun*	Jul*	Aug	Sep*	Oct	Nov*
Avg Weekly Hog Sltr	2,350,000	2,295,000	2,483,000	2,522,000	2,677,000	2,651,000
Year Ago	2,533,800	2,453,300	2,599,400	2,521,200	2,695,800	2,611,300
Avg Weekly Barrow & Gilt Sltr	2,282,000	2,230,000	2,415,000	2,455,000	2,610,000	2,585,000
Year Ago	2,461,200	2,386,700	2,528,400	2,452,400	2,627,100	2,546,100
Avg Weekly Sow Sltr	63,000	59,000	61,000	60,000	61,000	59,000
Year Ago	67,200	61,300	65,300	63,100	62,700	59,600
Cutout Value	$118.00	$115.00	$107.00	$97.50	$91.00	$86.50
Year Ago	$68.90	$67.44	$72.11	$84.90	$94.11	$81.10
CME Lean Hog Index	$111.50	$109.50	$98.50	$85.50	$79.50	$73.50
Year Ago	$48.89	$48.27	$54.81	$68.39	$77.37	$69.51

**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.