

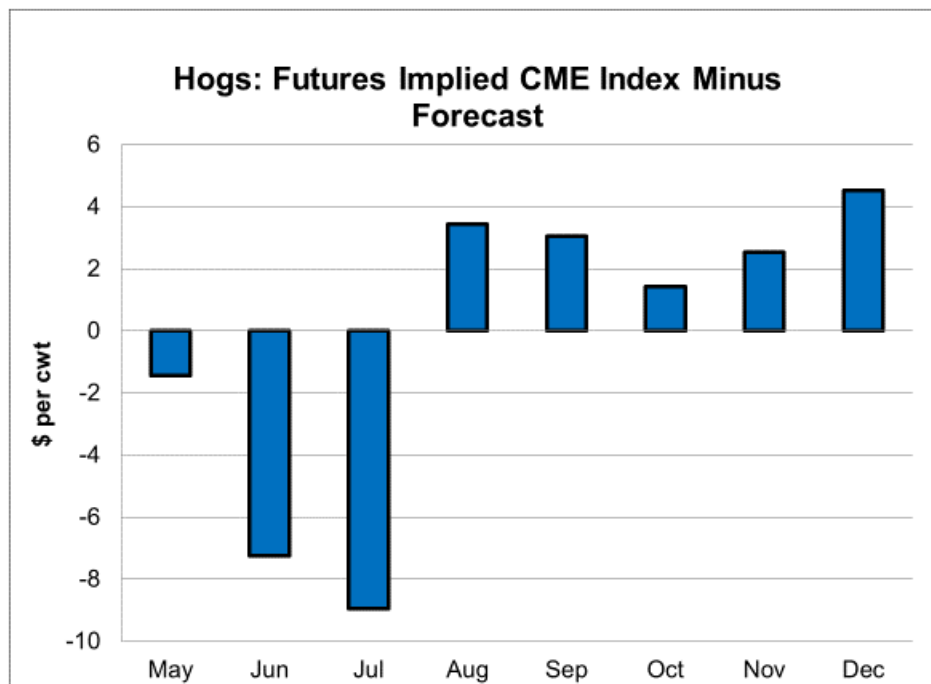
# Trading Hogs

## .... from a meat market perspective

A commentary by Kevin Bost

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May 7, 2019



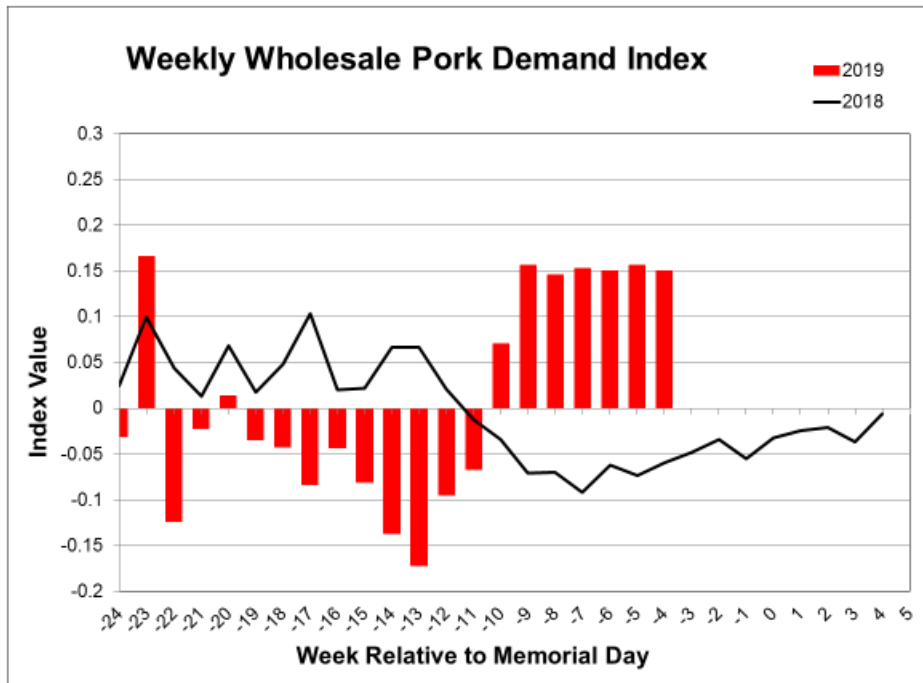
My only position in the hog market right now is short of June \$88 puts. I had considered an outright purchase of the June contract near \$86.00--which, in hindsight, would have been

looking good after today's close--but I chose instead to add to my existing options position. Why? Because I was quite surprised that the front end of the board reacted so negatively to the announcement that U.S. tariffs on imports of Chinese goods would be increased this week if no deal is struck; and the prospect of collecting a 400-point option premium with a sub-\$84.00 breakeven seemed a more suitable alternative. I remind myself that I have less confidence in my cash market forecasts than usual, and the futures market's unexpected behavior didn't exactly boost my confidence.

Anyway, the June contract will have to expire below \$84.00 to turn this position into a loss, and in that case, the CME Lean Hog Index would have to gain less than \$1.50 per cwt between now and June 14. Now, it's not *that* unusual for the cash hog market to lose ground from the second week of May to the second week of June; it has happened eight times in the last 20 years. However, it is

quite unlikely under the current circumstances, because of the trajectory of wholesale pork demand. I should explain.

Over the past six weeks, demand has followed a seasonally typical pattern, after making a giant leap in March. This is reflected by the almost perfectly flat pattern in the seasonally adjusted demand index:



If the index were to remain on its seasonally typical path, and if hog slaughter remains aligned with the fall pig crop estimate (as it has so far), then the pork cutout value will

rise to \$95 per cwt by the second week of June. And even if packer margins were to widen \$3 per cwt in the meantime, the CME Lean Hog Index would reach \$90 by then.

It would be easier to envision a slowdown in the rate of demand, were it not for the facts that: a) pork belly prices stand at eight-week lows and are currently in a "demand-buying" mode; and b) it looks as though pork loins will be actively featured from now through Memorial Day, as they have been available for May delivery at cheap prices relative to beef. If demand is to veer from its seasonally typical course, it is more likely to do so toward the stronger side. I think it's safe to say that nothing on the menu of major pork products has priced itself out of competition just yet.

The forecasts shown in the table below, relative to which the June and July contracts appear to be considerably undervalued, include the assumption that U.S. pork exports to the "Greater China" region have increased from about 50 million pounds in March to 95 million pounds here in May, and will increase further to 110 million pounds in June. These projections are in line with the

quantities that I *think* are already being produced for export to China, not contingent upon any relaxation of Chinese tariffs schedule. I am guessing that there will be no material reduction in Chinese tariffs until mid-summer. This is why I was so surprised by yesterday's limit-down response in the June contract to the "news" that a trade agreement may not be just around the corner....

Forecasts:

	May*	Jun	Jul*	Aug	Sep*	Oct
Avg Weekly Hog Sltr	2,316,000	2,287,000	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	2,252,000	2,220,000	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	57,000	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	\$88.00	\$99.50	\$104.50	\$101.50	\$95.50	\$96.00
Year Ago	\$73.59	\$83.18	\$82.70	\$69.05	\$74.33	\$78.56
CME Lean Hog Index	\$86.00	\$96.50	\$101.00	\$91.00	\$80.00	\$85.00
Year Ago	\$66.77	\$81.13	\$78.73	\$55.46	\$55.31	\$66.89

*\*Slaughter projections include holiday-shortened weeks*

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