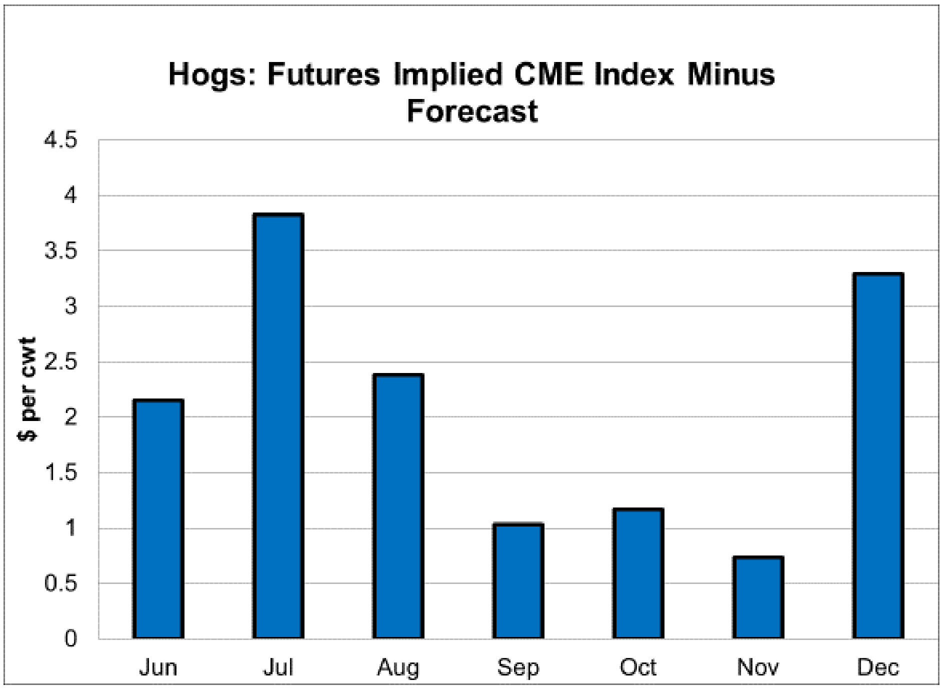
Trading Hogs
…. from a meat market perspective

A commentary by Kevin Bost

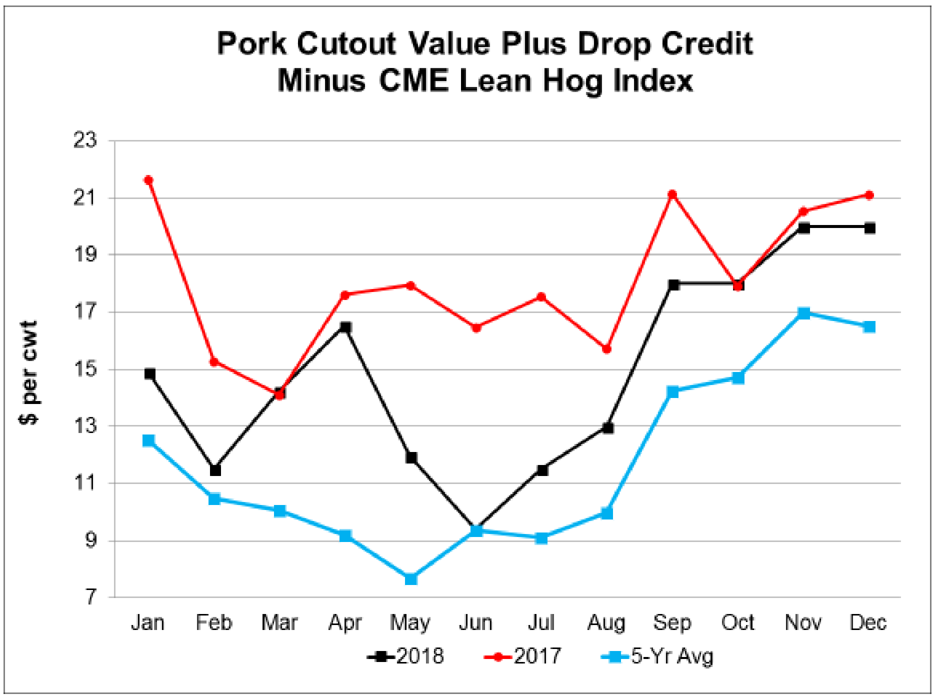
June 10, 2018



I remain short of August hogs against a long position in the October contract, although my fundamental conviction is not as strong as it once was. There is a technical appeal to this spread, which is that *if* the August premium closes below $12.65, then it would complete a double-top formation that would measure to about $11.00….and it settled right on that mark on Friday. And so it deserves a brief opportunity to make this happen. By "brief" I mean that if it does not happen within the next couple of days, I probably will close out the position.

One major reason why I entered this spread was because I thought that August hogs would revisit their contract low of $72.45, and that they would lose ground to the deferred contracts in the process. Now, I'm not so sure. What has caused me to approach the short side of the summertime market with greater caution is the behavior of the packer margin. It has become significantly tighter than I had anticipated and frankly, I don't know why. The quoted gross margin has narrowed from $13.25 per cwt a month ago to just $8.50 at the end of this past week and for all I know, it could remain there through the end of June and into July. On this date a year ago, it stood at $17.13. True, there is more slaughter capacity and there are two additional plants operating today than there were at this time last year; but that condition also existed a month ago, and the year-to-year difference was only $3.50. Plus, as measured by the five-year average, it is counter seasonal for the packer margin to narrow from the first week of May to the first week of June. There is something going on here that I cannot explain, and I cannot ignore it.

In the picture below, I take a step back and look the monthly averages. It's difficult to find a pattern in this picture. But it is beginning to look as though the abberations were in March and April, when margins were close to those of a year earlier. I think we can expect some seasonal widening of the packer margin between now and August, but how much? It could be as narrow as $11.00 per cwt in August, and it could be as wide as $15. It makes a big difference; combined with an average pork cutout value of $82.50—about which I have some degree of confidence—a $15 margin would result in a CME Lean Hog Index of $72.75 per cwt and an $11 margin would bring the Index up to $76.75. Always allowing for the more bullish possibilities whenever contemplating a short-side bet, I am inclined to assume the latter in my trading strategy….which makes a short position at my original target of $79.50 look….well, not all that appealing.



Finally, in regard to packer margins, I am willing to assume that since slaughter capacity should be closer to that of a year earlier in the fall, and since hog supplies should be about 3% larger, packer margins will not be much different from a year earlier. With each week that goes by, it becomes more doubtful that either of the two new plants will have added a second shift by October 1.

I must also say that the market composition figures are nebulously bullish. The short position among large speculators accounts for an unusually big share of total open interest (15.6% as of last Tuesday), while commercial traders are, relatively speaking, aligned toward the long side of the market—they carry an unusually small short position and an unusually large long position. Perhaps I am giving commercial traders too much credit for having insight into the destination of the cash market, but it's a pretty safe bet that they know more than I.

The picture on the first page mandates that I continue to approach the hog market from the short side, but at the moment I am aiming higher. There is a good chance that the CME Index will have reached its peak by June 22, the week after next. In the meantime, I will try to sell the August contract near $81.00 or the October contract near $68.50. There is a gap on the daily chart of October hogs at $67.35….

Forecasts:

	Jun	Jul*	Aug	Sep*	Oct	Nov*
Avg Weekly Hog Sltr	2,273,000	2,212,000	2,395,000	2,476,000	2,577,000	2,608,000
Year Ago	2,183,400	2,127,700	2,304,600	2,420,500	2,503,700	2,422,100
Avg Weekly Barrow & Gilt Sltr	2,205,000	2,150,000	2,330,000	2,410,000	2,510,000	2,540,000
Year Ago	2,117,200	2,068,800	2,241,600	2,357,500	2,436,800	2,357,600
Avg Weekly Sow Sltr	60,000	55,000	57,000	58,000	59,000	60,000
Year Ago	58,800	52,100	55,500	55,500	59,300	57,300
Cutout Value	$81.50	$83.25	$82.50	$79.00	$76.00	$74.00
Year Ago	$97.04	$103.48	$91.67	$77.89	$74.51	$81.18
CME Lean Hog Index	$77.25	$77.00	$76.50	$65.00	$63.00	$59.00
Year Ago	$86.09	$91.47	$81.41	$62.02	$61.73	$65.88

**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.