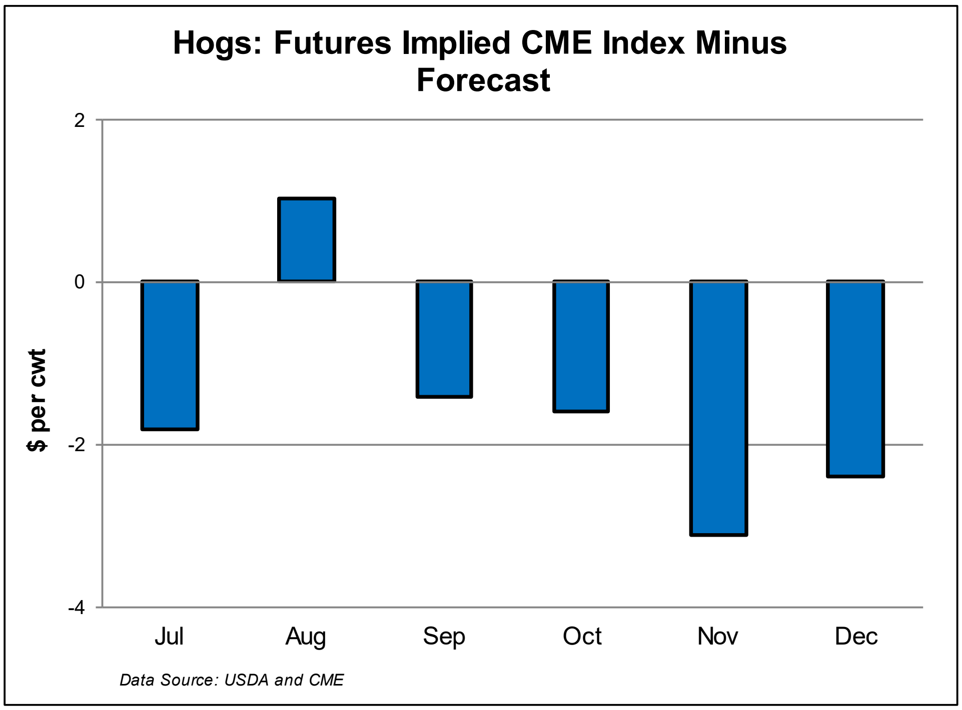
Trading Hogs
…. from a meat market perspective
A commentary by Kevin Bost

June 27, 2021



The downward momentum in the cash markets is intense, and I have to remind myself that this setback in the CME Lean Hog Index is only nine days old. The uptrend lasted six months. From this angle, it seems obvious that trying to pick a bottom in the hog market is a very dangerous game right now. And with the possible exception of the July contract, I will avoid doing so.

On the subject of July futures, though, my best guess is that the Index will situate near $104 per cwt in the week ending July 17 (the quote for Monday's kill appears to be $111-something), and so I will seriously consider a small long position at $98.85. This is a conspicuous support level on the daily chart. If I have the nerve to go through with it, I would risk this trade down to a close below $97.85. A 100-point risk vis-à-vis a 500-point profit potential easily satisfies the risk/reward criterion.

But my real interest is in trying to capture another leg down in the August contract after a sizeable bounce. The challenge is deciding exactly when to begin selling on the way up. On its way down, August hogs left three gaps on the daily chart: $103.47, $111.70, and $116.25. Last week I stated in so many words that I expected the gap at $111.70 to be filled; I couldn't say the same today. As for the highest gap, this one does not seem to be in play. If my cash market forecast is any good, then the August contract will never trade back up to $116.25.

There are a couple other technical considerations. First is the fact that the $105 area was previously a major support level, and now should present formidable resistance. Another resistance level, this one not so readily apparent, lies at $106.70; the most recent, earnest attempt to rally occurred last Tuesday, and it stopped at that price. Thirdly, a 38.2% retracement from last week's low of $96.50 would measure to $105.70; a 50% retracement would measure to $108.52.

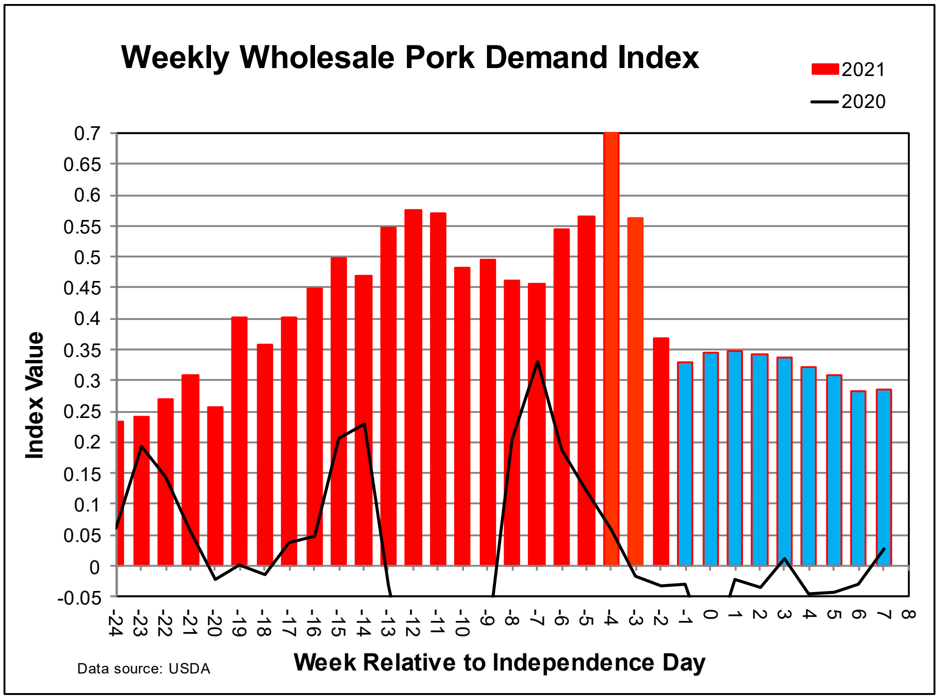
And so my plan is to scale into a short position in modest increments, beginning at approximately $105.00 and finishing at $111.70. Considering how oversold the board is right now (August hogs stood $6.40 below their ten-day moving average at Friday's close), I would have to think that some sort of rally would be in order. However, the long position held by managed money traders remains very large, accounting for 20% of the total reportable "pie"; there is still a lot of potential long liquidation from the funds. [I should probably explain: if we sum the number of futures contracts held by long and short hedgers; long and short swap dealers; long, short, and spread managed money traders; and long, short, and spread unclassified reportable-sized traders; the long holdings among managed money traders account for 20% of this sum—or at least it did, as of last Tuesday.]

In regard to the ultimate value of the August contract, my guess is that in the week ending August 14, the pork cutout value should stand at about $105 per cwt, and the gross packer margin (cutout value plus drop credit minus the CME Index) at $15 per cwt; this combination would place the Index at $96.75.

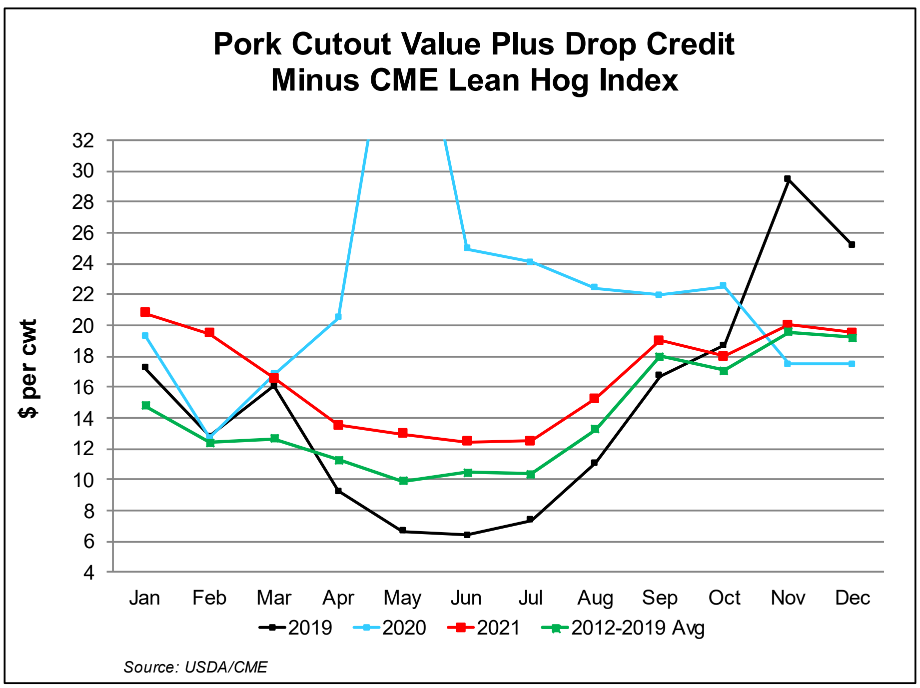
The $105 cutout value would be the result of an average weekly kill of 2,487,000 in August and a typical seasonal pattern in wholesale pork demand from this point forward. The first graph on the next page shows how the weekly demand index has made a substantial downward adjustment over the past two weeks; and now that this adjustment has been made, presumably it will remain flat through August. It is the most objective assumption regarding pork demand that I can make at this juncture.

The slaughter projection is also the most objective that I can come up with. Following an average weekly kill of 2,412,000 over the last three weeks, an average of 2,368,000 in the non-holiday weeks of July and 2,486,000 in August would place the total June-August kill at precisely the 25-year average ratio to last winter's pig crop. This suggests that hog slaughter will not go any lower from here, but there will be no material increase until the first week of August.

The packer margin index has been quite volatile lately, ranging from as high as $22 per cwt in the first week of June to only $2 this past week. But the monthly averages have remained relatively stable and moderately above the 2012-2019 average. This I show in the second graph on the next page.



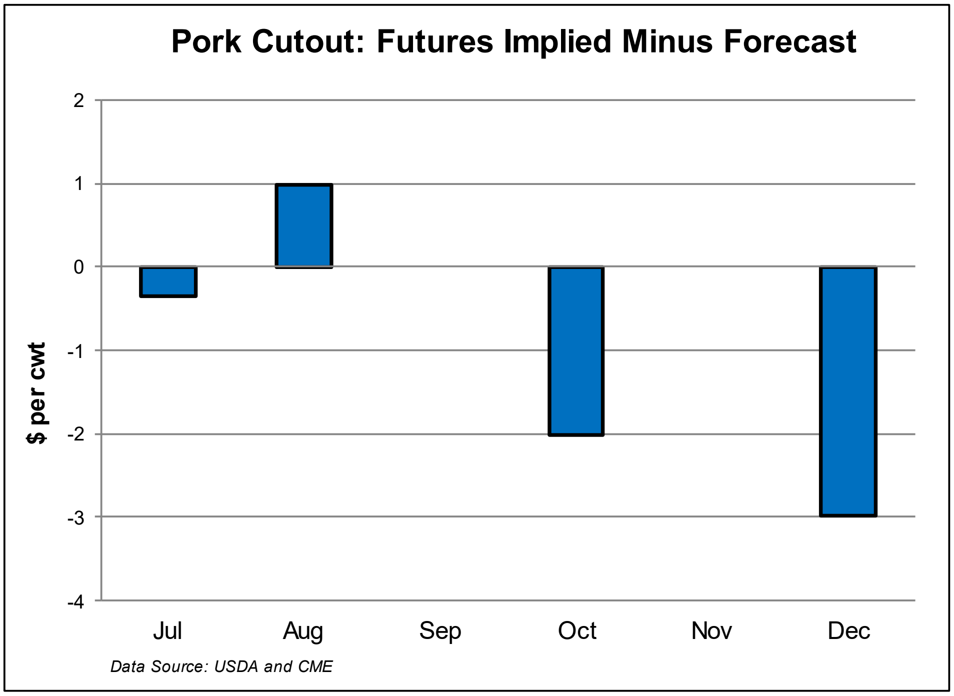
Thus, I expect the CME Index to fall much farther than the cutout value in the weeks ahead. A bit of stability in the latter should allow the margin index to quickly return to $13 or so. One would think that this might make the long side of the July cutout value a better play than the long side of the July hog futures, but the board is already pricing in an expeditious recovery in packer margins.



But as I am wont to do whenever I am contemplating a short position, I have to consider a more bullishly skewed set of assumptions. One realistic possibility is that the weekly demand index shown above will snap back to a value of .55 instead of the .31 that I am projecting for the second week of August.

Another not-so-far-fetched possibility is that instead of landing at $15 per cwt, the packer margin index will merely match the longer-term average of $13 in mid-August.

Together, this combination of stronger demand and tighter packer margins would land the CME Index in the second week of August at $115.75. This "what-if" scenario is indeed pretty extreme, especially considering that it would involve a cutout value of $122 per cwt, and the stronger the cutout value, the wider the packer margin tends to be.



Forecasts:

	Jul*	Aug	Sep*	Oct	Nov*	Dec*
Avg Weekly Hog Sltr	2,294,000	2,487,000	2,516,000	2,640,000	2,601,000	2,454,000
Year Ago	2,453,300	2,599,400	2,521,200	2,695,800	2,611,300	2,446,000
Avg Weekly Barrow & Gilt Sltr	2,230,000	2,420,000	2,450,000	2,575,000	2,535,000	2,390,000
Year Ago	2,386,700	2,528,400	2,452,400	2,627,100	2,546,100	2,381,300
Avg Weekly Sow Sltr	58,000	60,000	59,000	59,000	59,000	58,000
Year Ago	61,300	65,300	63,100	62,700	59,600	59,300
Cutout Value	$109.00	$104.00	$99.00	$97.00	$92.00	$92.00
Year Ago	$67.44	$72.11	$84.90	$94.11	$81.10	$74.93
CME Lean Hog Index	$103.50	$96.00	$87.00	$86.00	$79.00	$80.00
Year Ago	$48.27	$54.81	$68.39	$77.37	$69.51	$63.39

**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.