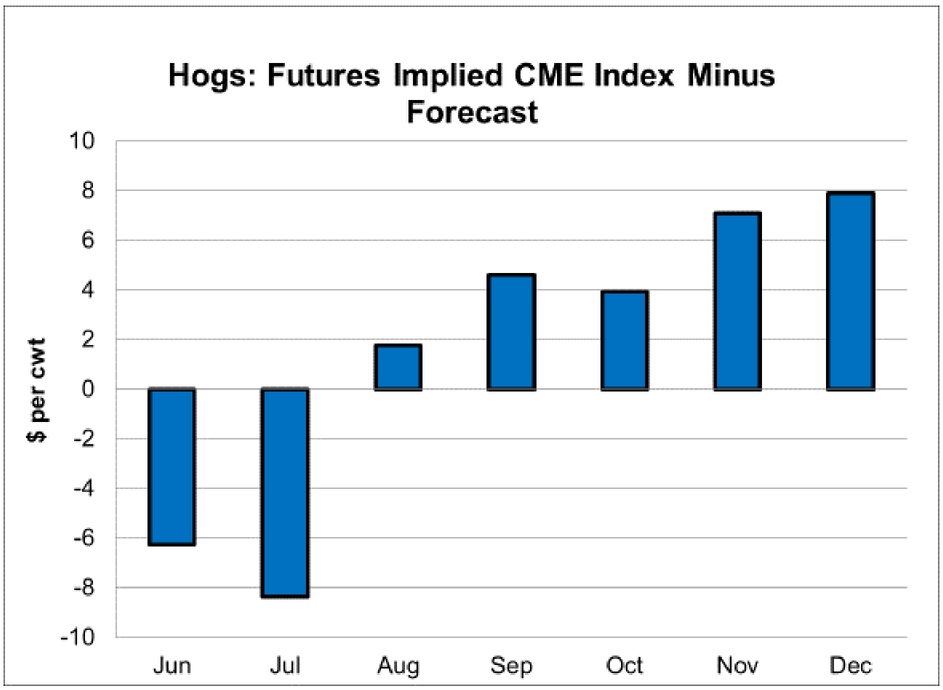
Trading Hogs
…. from a meat market perspective
A commentary by Kevin Bost

June 3, 2019



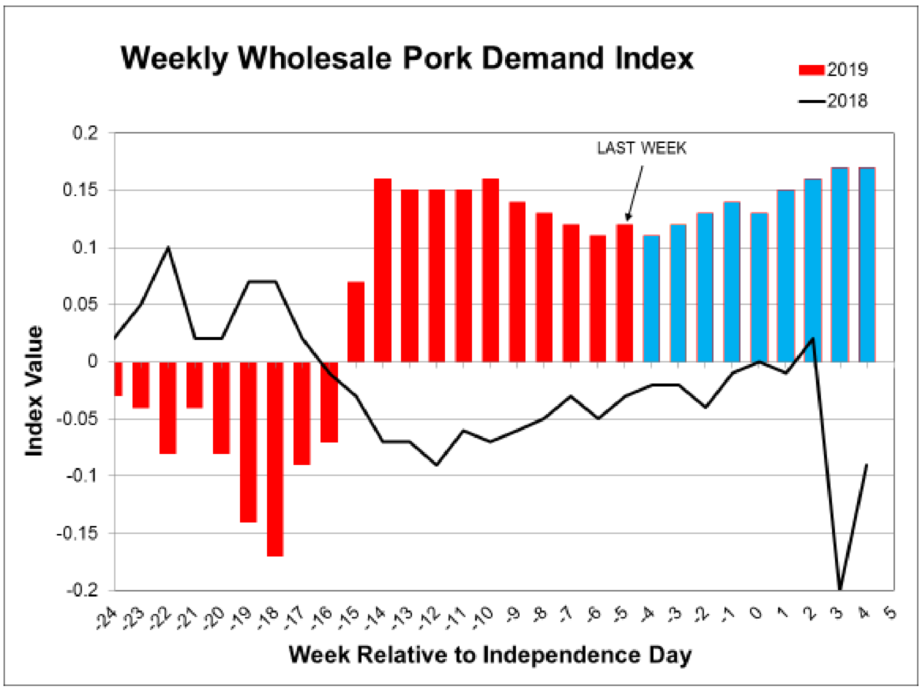
I have abandoned the short position in the June $88 puts, and now hold only a modest outright long position in the July contract. With just two weeks remaining before the June contract expires and the CME Index backtracking throughout the past week, the July contract is a much better bet.

But how good *is* it, really? Let's examine some very conservative, if not pessimistic, variations.

First of all, the CME Lean Hog Index for today's kill stands in the neighborhood of $81.50 per cwt. It has slipped $3.20 since May 16, and in the process has fallen below a support level established on May 6 at $82.55. While I regard this as a minor violation of the uptrend (which remains intact in the broader picture), it is a bit disconcerting nonetheless, and could be a signal that the market is not ready to turn back upward.

The July futures contract starts the week at a premium to the cash market of $4.50, which is large by historical standards but not extreme; last year it averaged $4.90 in the first week of June, and in 2016 it averaged $6.62.

The real question marks are in the areas of wholesale pork demand and packer margins. In regard to the former, in the picture below I show my projections of the seasonally adjusted demand index through July:

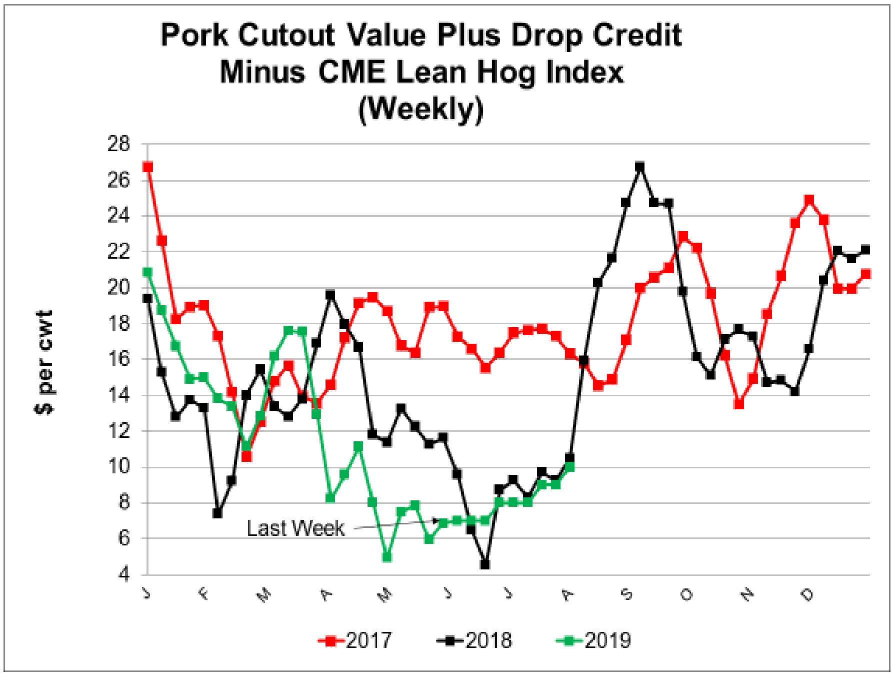


When paired with an average weekly kill of 2,237,000 in July (up 3.5% from a year earlier) this demand projection places the pork cutout value at $97.50 per cwt, as shown in the forecast table below.

This demand projection assumes that there will be no major developments on the export front--as in a U.S./China trade agreement or a sudden burst of new sales; but it does assume that demand will slightly outperform the seasonal norm. I *think* that under the circumstances, a very conservative scenario would be if the demand index value were to remain at its recent low point (.11 on the vertical axis). In that case, the cutout value would wind up at about $94.50 in the middle of July.

My current projection of the gross packer margin index (shown on the next page) in July is just below $9 per cwt. This is perhaps a shade on the conservative side already, since it averaged $5.94 this past week and has not exceeded $8 since the week ended April 20. But let's say that it widens even further to $12, which would be $3 wider than a year earlier (the last time it managed to exceed the year-earlier figure was in the third week of March).

A cutout value of $94.50 coupled with a $12 gross packer margin would yield a CME Index of $88 in mid-July.



Finally, my forecast includes the assumption that U.S. pork exports to China/Hong Kong/Taiwan will expand at their current, gradual pace and will reach 100 million pounds in July vs. 52 million in March. But let's say that they reach only 75 million pounds by July. In that case, the cutout value forecast under the pessimistic demand scenario becomes $93; and applying a $12 packer margin, the forecast of the CME Index in mid-July becomes $86.50.

Thus, it is highly likely that the July futures contract is undervalued as of Friday's close. But as usual, I would regard a close below a major support level as a signal that somewhere in the process--whether it be in production, in demand, or in packer margins--I am missing the mark. That major support level lies at $84.32, and so this is where my close-only stop is situated. Given the compelling bullish argument and upside potential, and given the small amount of additional risk, I plan to add to my long position at $84.50.

Forecasts:

	Jun	Jul*	Aug	Sep*	Oct	Nov*
Avg Weekly Hog Sltr	2,277,000	2,237,000	2,442,000	2,516,000	2,615,000	2,587,000
Year Ago	2,220,400	2,160,700	2,423,700	2,359,000	2,550,000	2,498,800
Avg Weekly Barrow & Gilt Sltr	2,210,000	2,175,000	2,375,000	2,450,000	2,545,000	2,520,000
Year Ago	2,154,700	2,099,000	2,358,200	2,294,600	2,480,900	2,433,500
Avg Weekly Sow Sltr	59,000	55,000	59,000	58,000	62,000	59,000
Year Ago	58,400	54,700	58,100	56,500	61,100	57,300
Cutout Value	$92.00	$97.50	$95.50	$87.50	$88.00	$83.50
Year Ago	$83.18	$82.70	$69.05	$74.33	$78.56	$69.41
CME Lean Hog Index	$90.00	$94.50	$85.00	$72.50	$76.00	$69.50
Year Ago	$81.13	$78.73	$55.46	$55.31	$66.89	$59.17

**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.