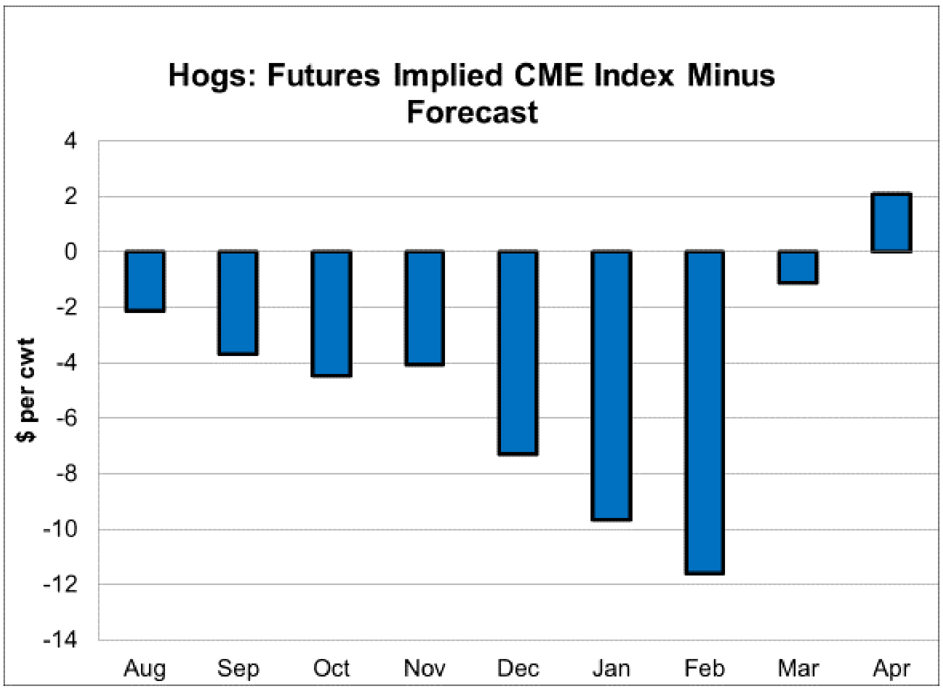
Trading Hogs
…. from a meat market perspective

A commentary by Kevin Bost

July 11, 2018



I have no bet on the table in the hog market right now, because the picture at left tells me that as far as "positions" are concerned, I can only approach them from the long side; but the chart and the direction of the cash markets tell me that I should trade from the short side. At *least,* they tell me that no matter how undervalued the board may be, now is probably not a good time to expect a major bottom in futures prices.

I think I can see where my trading strategy is headed for the next month or so. Most likely, I will be aiming for short-lived opportunities to capture relatively small moves, using tight stops. This sounds like a stupid thing to say (of *course* you're going to follow these rules!) unless you recognize that this is not my *modus operandi;* normally I am taking positions on the notion that the board has recently established a major high or low, trying to take advantage of markets that are considerably over- or undervalued. There is no such opportunity around the corner.

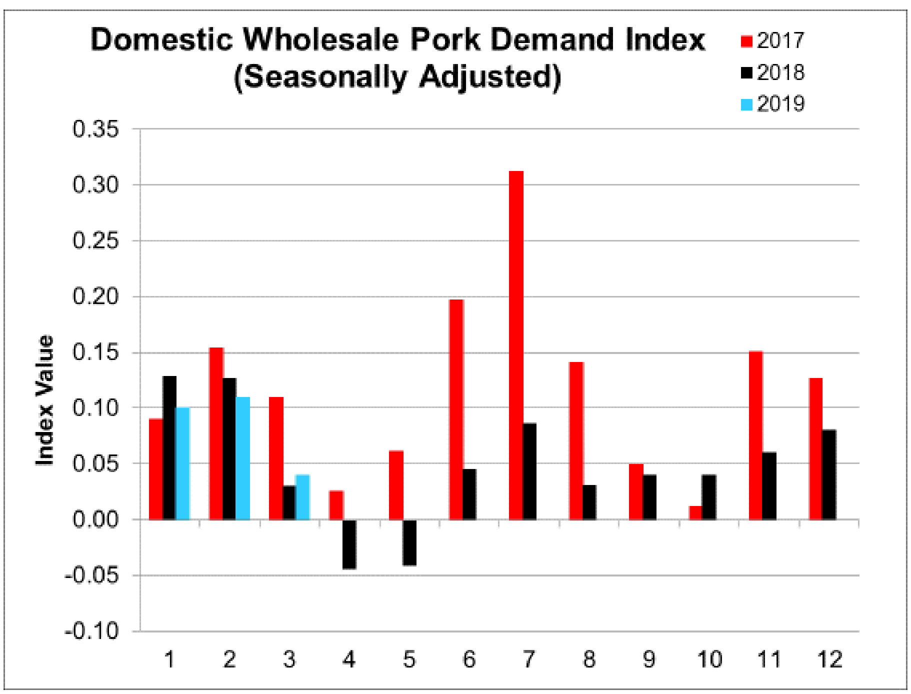
So, then, I am willing to trade hogs from both the long side in the deferred contracts (December of February) and the short side in the nearer contracts under the right circumstances. In fact, I am willing to buy February hogs at $55.00, risking a single close below $54.00 and expecting a return to the previous contract low of $58.85. The only reason I have for choosing $55.00 is its psychological appeal. And I am choosing the February contract because it appears to be the most undervalued of all, and because it presumably will be subject to less of the technically-motivated selling pressure than the nearby contracts.

As for short-side trades, I prefer the October contract to the August because the risk: reward parameters are "cleaner". A short position in August hogs would have to be risked up to a close above $77.00, and "fair value" looks like it should be $73-something (the current single-day Index is very close to $81.00). In oder to justify a sale within these parameters, the entry point would have to be $76.00 or higher. It seems easier for the October contract to reach an appropriate entry level. This is not within "earshot" at the moment, but I notice that on the day after the Hogs and Pigs report was released (June 29) the October contract left a gap on the daily chart at $60.95. Since my best guess is that the CME Index will average about $59, there is a pretty decent chance that this gap will be filled. The position would be risked up to a close above $62.00.

What, pray tell, could possibly push October hogs up to $60.95? Well, I consider what the market's response would be if we were to wake up to the news that the U.S. and China had reached some sort of agreement or at least "called a truce" in the tariff dispute. Concrete or not, the reaction would probably be exaggerated.

On that subject, the forecasts shown in the table below assume that the tariffs that are in place today will stand indefinitely, and they will reduce combined U.S. pork exports to China/Hong Kong to around 25 million pounds in December vs. 42 million a year earlier. The forecasts also assume that exports to Mexico will amount to 165 million pounds compared with 175 million in Decmber 2017. This may not seem like a sufficient reduction in shipments to Mexico, but keep in mind that we're talking about a tariff of "only" 20%, and that pork prices will be substantially lower than a year earlier.

With respect to demand, an average cutout value of $73.50 per cwt in December assumes that demand for pork at the wholesale level will be significantly weaker than it was at the end of last year, which is a pretty benign assumption, as I show in the picture below:



Finally, I am assuming that gross packer margins in the fourth quarter will be about the same as they were in Q4 2017. If there is to be one full shift operating at both of the new plants (Coldwater and Sioux City) by then, and some sort of 'initialization rate" at the latter, then the increase in packing capacity should just about offset the increase in hog supplies.

Under these assumptions, the December contract appears to be worth something in the neighborhood of $57 per cwt. The board is obviously discounting considerably more bearish conditions regarding production, exports, demand, or packer margins….or all of the above. But until something happens to change the market psychology, I will trade only the February contract from the long side, and only from a short-term perspective.

Forecasts:

	Jul*	Aug	Sep*	Oct	Nov*	Dec*
Avg Weekly Hog Sltr	2,205,000	2,396,000	2,487,000	2,572,000	2,568,000	2,487,000
Year Ago	2,127,700	2,304,600	2,420,500	2,503,700	2,422,100	2,420,500
Avg Weekly Barrow & Gilt Sltr	2,141,000	2,330,000	2,420,000	2,505,000	2,500,000	2,420,000
Year Ago	2,068,800	2,241,600	2,357,500	2,436,800	2,357,600	2,356,000
Avg Weekly Sow Sltr	56,000	58,000	59,000	59,000	60,000	59,000
Year Ago	52,100	55,500	55,500	59,300	57,300	56,800
Cutout Value	$85.00	$79.00	$74.50	$72.50	$71.50	$73.50
Year Ago	$103.48	$91.67	$77.89	$74.51	$81.18	$79.14
CME Lean Hog Index	$79.50	$72.00	$61.00	$59.00	$56.00	$58.00
Year Ago	$91.47	$81.41	$62.02	$61.73	$65.88	$63.28

**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.