Trading Hogs

…. from a meat market perspective

A commentary by Kevin Bost

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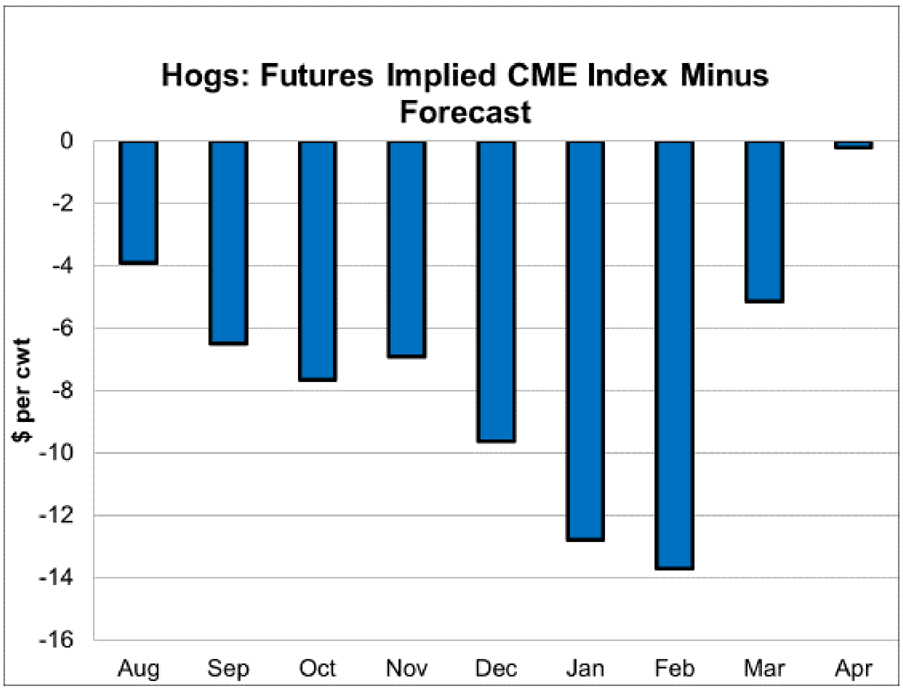

I am still inclined to trade the hog market from the long side, with tight constraints. No matter how cheap the February contract might appear, I am not ready to "park" on the long side of this market and wait for a $14 per cwt rally. Cash hog prices clearly have turned downward, and at this point none of us knows how far the downtrend will carry. I have an idea, of course, but I am making some critical assumptions regarding pork demand and packer margins which may or may not be valid. There are too many potential "potholes" in the road over the next few months that could render my forecasts too high. Apart from the obvious risk that the foreign trade situation could worsen, the possibility exists that neither the new plant in Coldwater nor its counterpart in Sioux City will materially expand production schedules by the time the seasonally heaviest hog supplies begin to show up this fall. [Representatives from Triumph/Seaboard insist they they are on target to add a second shift in October, but I'm just sayin'….] My forecasts shown in the table below assume that slaughter capacity will expand to match the increase in hog supplies, and that packer margins in the fourth quarter will approximate those of a year earlier in the fourth quarter. They also assume that the tariffs on U.S. pork imposed by Mexico and China will remain (indefinitely) as they are today.

The most objective forecast I can construct at this point tells me that the board is significantly undervalued, and this precludes me from betting the short side unless the risk/reward proposition is exceptional. If, for some absurd reason, the October contract should trade up to $60.95 per cwt any time soon, where it left a gap on the daily chart on the day after the *Hogs and Pigs* report, I would be willing to sell it even though it could be fairly-priced at that level. A short position from that level could be risked up to a close above $61.65, and there would be a good possibility that the descending cash market would draw October futures back down to around $55.50 (which looks like it will turn into an important price point). I do not expect this opportunity to present itself. Yet, in the back of my mind I consider how dramatic the response would be if the announcement came from On High that the recently-imposed tariffs would be rescinded. Whatever the response, it will probably be exaggerated—just as the imposition of the tariffs in the first place was overplayed in the livetock futures markets.

And so, I will try to take advantage of short-term trading opportunities from the long side of the February contract which would offer a profit objective at least three times greater than the risk; another prerequisite would be that my stop-loss be placed at a meaningful price level. At the moment, I can identify two such points: one is the contract low of $51.95; the other is the psychologically important price of $50.00. I'll add a third caveat: the board must be sufficiently oversold before I will buy it. With the February contract just now making its first run at the contract low it established one week ago, I am not ready to bet against a close below $51.95 just yet. If this low is tested, and it holds, and is followed by another rebound, then I will probably make a move. A *probable* upside target on such a trade would be in the neighborhood of $57.00. But I'm getting ahead of myself.

A long position in February hogs has the making of a massive profit opportunity. But like the untested thoroghbred that fetches $1 million at the yearling auction in the spring, the February hog contract will have tested to see how it holds up under a barrage of negative news in the months ahead. [That was a dumb analogy, wasn't it?] Even if my current forecasts turn out to be spot-on, it would be easy to lose a lot of money trying to get a long position to "stick"….

Forecasts:

	Aug	Sep*	Oct	Nov*	Dec*	Jan*
Avg Weekly Hog Sltr	2,396,000	2,487,000	2,572,000	2,568,000	2,487,000	2,454,000
Year Ago	2,304,600	2,420,500	2,503,700	2,422,100	2,420,500	2,339,270
Avg Weekly Barrow & Gilt Sltr	2,330,000	2,420,000	2,505,000	2,500,000	2,420,000	2,385,000
Year Ago	2,241,600	2,357,500	2,436,800	2,357,600	2,356,000	2,273,500
Avg Weekly Sow Sltr	58,000	59,000	59,000	60,000	59,000	61,000
Year Ago	55,500	55,500	59,300	57,300	56,800	57,620
Cutout Value	$78.50	$74.00	$72.00	$71.00	$72.50	$75.00
Year Ago	$91.67	$77.89	$74.51	$81.18	$79.14	$80.74
CME Lean Hog Index	$71.50	$61.50	$59.50	$55.50	$57.00	$65.50
Year Ago	$81.41	$62.02	$61.73	$65.88	$63.28	$70.97

**Slaughter projections include holiday-shortened weeks*

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