

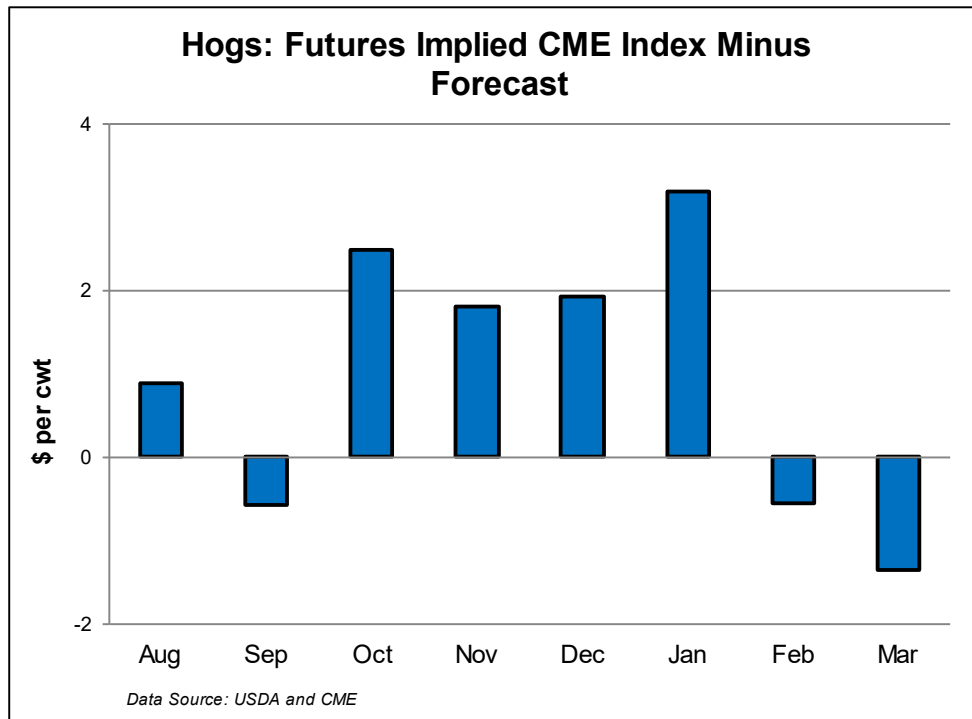
# Trading Hogs

## .... from a meat market perspective

A commentary by Kevin Bost

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July 19, 2021



The picture to the left tells me that I don't need to be in a hurry to re-engage in the hog market right now. My assessment of "fair value" in the August contract has been bumped up because of the considerably smaller-than-expected kills in the last few

weeks, which have prompted me to reduce slaughter projections between now and the end of August (but not beyond). In regard to the summertime hog supply, the writing is on the wall, and I have to respect that.

But my allegiance remains to the short side, simply because the next major move in the cash markets will be downward. Even after taking the tighter supply into account, it is still very likely that production has bottomed out. Perhaps a bigger issue is the amount of demand rationing that has occurred over the past four to five months, which could catch up to the market this fall or even sooner.

So if my next move is to sell August or October hogs, then for what price levels should I be aiming?

If I can believe my own forecasts, then the August contract is ultimately worth something in the neighborhood of \$105 per cwt. That price would be the result of

weekly kills in the 2,440,000 range by the middle of August and a middle-of-the-road assumption that wholesale pork demand merely follows a seasonally normal path between now and then. I am reasonably confident about these two variables. This combination would land the pork cutout value at \$114 per cwt at the time of expiration. I would have to see the board trading at least \$5 above the forecast in order to place a bet, and that would mean a futures price of \$110. There is still an open gap on the daily chart at \$111.70, though, and if the August futures contract is able to reach \$110, then it would probably go ahead and fill this gap. [There remains a higher gap at \$116.25, but I really don't think this one is in play.] And so I am willing to sell August hogs at \$111.70 if the opportunity presents itself.

As for the October contract, there are a couple of technical observations worthy of consideration. First of all, as long as we're talking about gaps, there are two: one just above last Friday's close at \$91.02, and another down at \$85.70. The latter has a good chance of being filled, since it is in the same general ballpark as my most objective cash price forecast. Secondly, there is no discernible resistance this side of \$95. If I am to require a futures price that is overvalued by at least \$5 before placing a bet, then that would mean waiting for a trade up to \$94. My targeted entry point, then, will be approximately \$95.00.

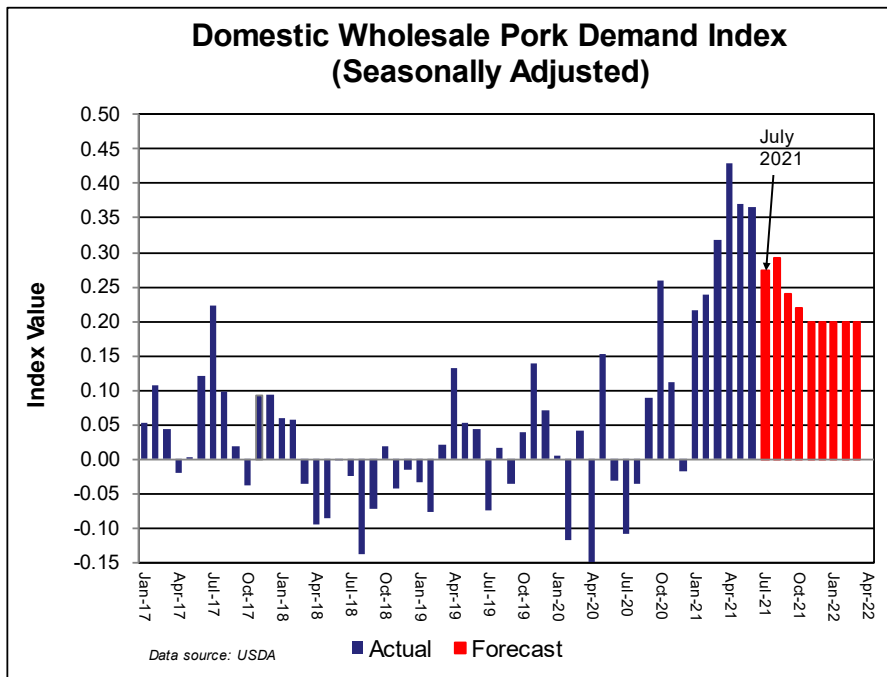
An important question, though, is whether or not we can trust USDA's count of the spring pig crop. Well, if I'm going to be my money on it, my answer would be no. So I have to examine the more bullish supply-side possibilities.

Currently I am factoring in a ratio of September-November hog slaughter to spring pig crop that is close to the midpoint of its ten-year range. This, of course, is the most objective outlook. If I move this ratio down to the bottom end of the *twenty-year* range—about as extreme as it can be, within reason—then weekly kills (including holidays) would average 2,485,000 in September; 2,620,000 in October; and 2,580,000 in November. Compared with 2019, these would be down 1.5%; 2.6%; and 2.1% respectively.

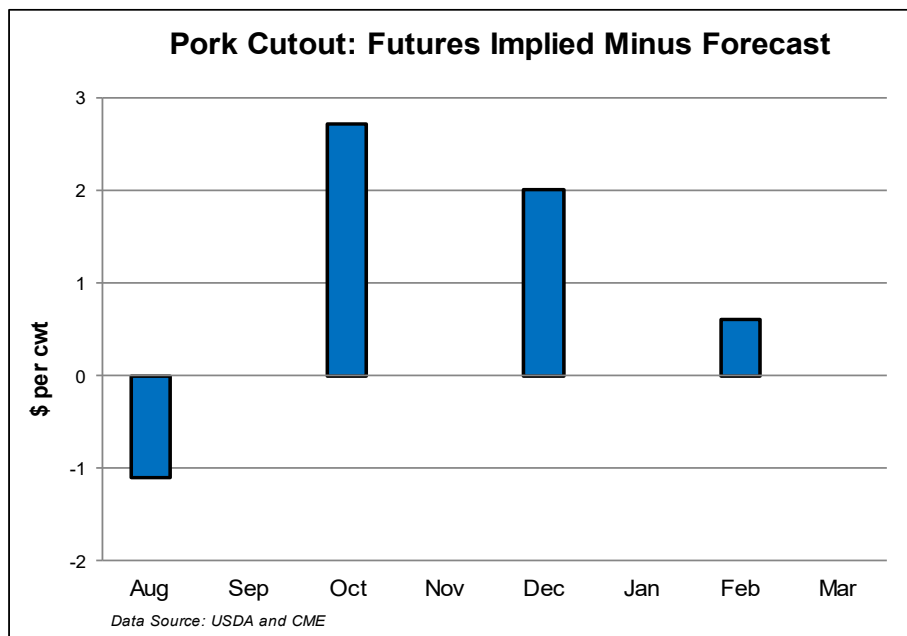
By itself, this sort of downward adjustment in projected hog slaughter would raise the cash price forecast by only about a dollar.

|               | Baseline Forecast | Smaller Hog Supply | Smaller Hog Supply + Stronger Demand |
|---------------|-------------------|--------------------|--------------------------------------|
| Sep Cutout    | \$104.50          | \$105.50           | \$108.00                             |
| Oct Cutout    | \$99.50           | \$100.50           | \$104.50                             |
| Nov Cutout    | \$94.00           | \$94.50            | \$100.00                             |
|               |                   |                    |                                      |
| Sep CME Index | \$92.50           | \$93.00            | \$95.50                              |
| Oct CME Index | \$88.50           | \$89.00            | \$93.00                              |
| Nov CME Index | \$80.50           | \$81.50            | \$86.50                              |

But what if we include a substantially stronger demand scenario on top of the smaller rate of production? First, I have to define “substantially stronger”. My baseline forecast assumes that although wholesale pork demand will decline from its current standing, it will remain quite high by historical standards. If instead I plug in a rate of demand that is no weaker than it is here in July (remember, we’re referring to seasonally adjusted rate), then it would place the demand index at .27. You can put this in perspective using the graph below:



Even in this scenario, the CME Lean Hog Index would wind up at \$93. Therefore, a sale of October hogs at \$95 would be fundamentally justifiable....as would a sale of the October cutout value at \$106.



Forecasts:

|                               | Aug       | Sep*      | Oct       | Nov*      | Dec*      | Jan       |
|-------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Avg Weekly Hog Sltr           | 2,457,000 | 2,506,000 | 2,640,000 | 2,601,000 | 2,454,000 | 2,542,000 |
| Year Ago                      | 2,599,400 | 2,521,200 | 2,695,800 | 2,611,300 | 2,446,000 | 2,712,800 |
| Avg Weekly Barrow & Gilt Sltr | 2,390,000 | 2,440,000 | 2,575,000 | 2,535,000 | 2,390,000 | 2,475,000 |
| Year Ago                      | 2,528,400 | 2,452,400 | 2,627,100 | 2,546,100 | 2,381,300 | 2,638,600 |
| Avg Weekly Sow Sltr           | 60,000    | 59,000    | 59,000    | 59,000    | 58,000    | 60,000    |
| Year Ago                      | 65,300    | 63,100    | 62,700    | 59,600    | 59,300    | 67,700    |
| Cutout Value                  | \$112.50  | \$104.50  | \$99.50   | \$94.00   | \$94.50   | \$91.00   |
| Year Ago                      | \$72.11   | \$84.90   | \$94.11   | \$81.10   | \$74.93   | \$80.31   |
| CME Lean Hog Index            | \$103.50  | \$92.50   | \$88.50   | \$80.50   | \$82.00   | \$81.50   |
| Year Ago                      | \$54.81   | \$68.39   | \$77.37   | \$69.51   | \$63.39   | \$65.48   |

*\*Slaughter projections include holiday-shortened weeks*

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