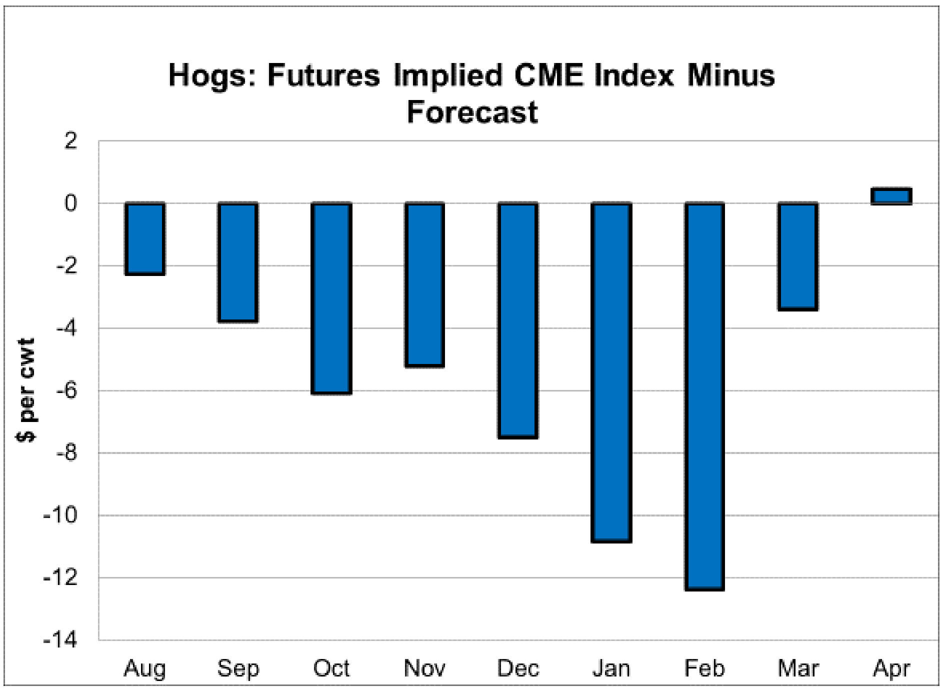
Trading Hogs
…. from a meat market perspective

A commentary by Kevin Bost

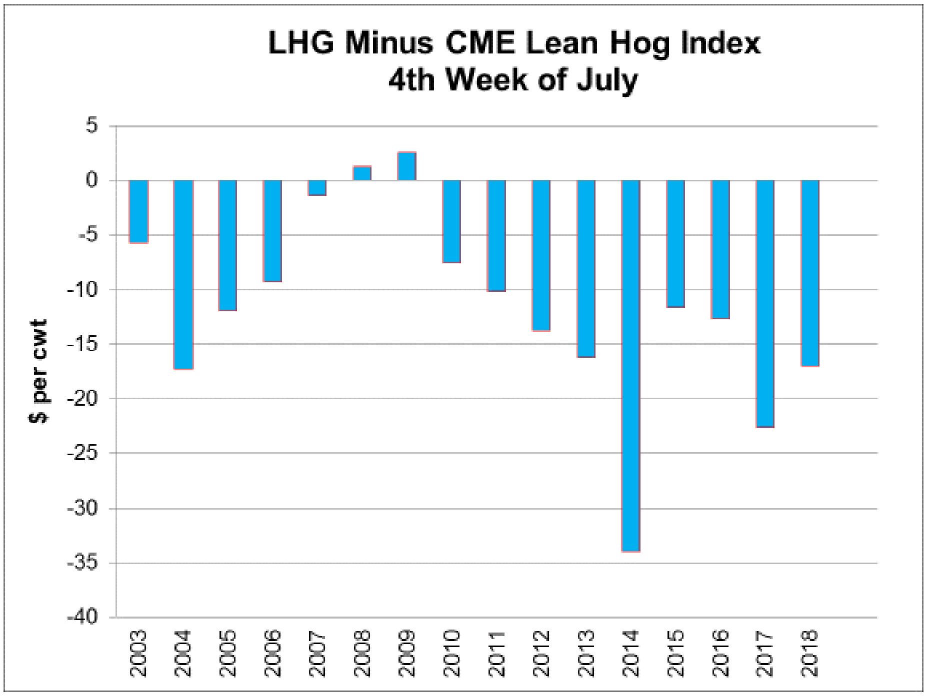
July 26, 2018



I remain on the sidelines of the hog market, continuing to search for a trading opportunity that is justifiable from a risk/reward standpoint. I emphasize the words "trading opportunity" as opposed to "position" because I am not convinced that the board has established its ultimate low just yet. The February contract, which is where my keenest interest lies, has not yet taken out any meaningful resistance after three days of recovery. A close above $57.00 would cause me to think differently. Until I can be confident that the bottom is "in", though, I am unwilling to "pitch my tent" and weather the seemingly inevitable slide in cash prices that is to come.

No doubt, the futures market has discounted a lot of bearish assumptions about pork demand, foreign trade, packer margins, etc. I estimate that today, the CME Lean Hog Index stands just below $73 per cwt, which places the February contract approximately $17 below the CME Index. On the next page I show how this compares with past years (since 2003, when the current Index came into existence). Compared with more recent history, the discount in the February contract is not really unusual….all the more reason for circumspection toward the long side of the futures market. I remind myself also that there is no theoretical limit on how far below the cash market the February contract can trade within the next couple of months.

Alongside are the the usual caveats. I am assuming that USDA's estimates of the spring pig crop and summer farrowings are accurate. I am assuming that wholesale pork demand will gradually recover through the fall and winter as persistently low prices work their way into the system. I am assuming that packer margins will track closely with a year earlier in the fourth and first quarters.



Any or all of these assumptions could be erroneous; but all lie near the center of the probability curve. And so, I think the forecast of a CME Index in the upper $50's in February is quite realistic. In regard to the packer margin question, I notice a newspaper report this week saying that the new Prestage Foods plant near Eagle Grove, Iowa, with a single-shift capacity of 10,000 hogs per day, is expected to begin operations "sometime this fall". This may not have an appreciable impact on industry-wide packer margins before the end of the year, but by February, it very well could. That impact, of course would be bullish of hog prices.

So, then, where is the short-term, long-side trading opportunity likely to present itself? It depends. If the February contract were to turn back downward before it gets to $57.00, then that price (i.e., the price at which the current recovery stalls) would establish the near-term upside objective. If that turns out to be $57.00, and if a close-only stop were to be placed at the conract low ($51.95), then something near $53.00 would be an acceptable entry point; that would make for a (roughly) 100-point risk vs. a 400-point profit potential.

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	$74.75	$73.00	$72.50	$71.00	$72.00	$74.00
Year Ago	$91.67	$77.89	$74.51	$81.18	$79.14	$80.74
CME Lean Hog Index	$67.50	$60.50	$60.00	$55.50	$56.50	$64.50
Year Ago	$81.41	$62.02	$61.73	$65.88	$63.28	$70.97

**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.