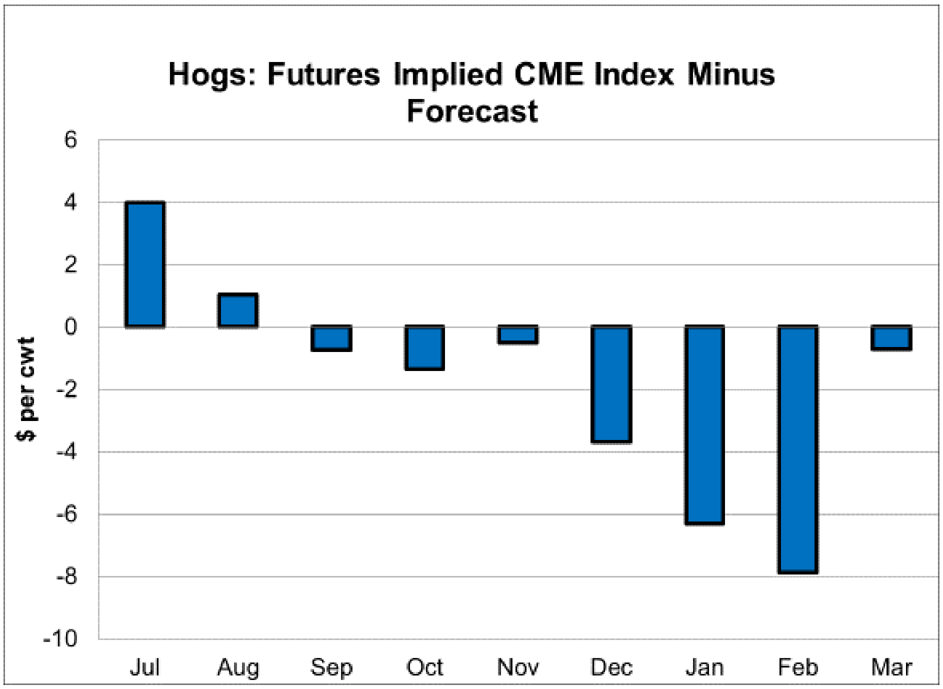
Trading Hogs
…. from a meat market perspective

A commentary by Kevin Bost

July 3, 2018



I have not yet found a justifiable place for a bet on the hog market. The picture at left tells me that there should be some merit in the long side of the February contract, and in a minute I'll explain the logic behind what looks like an error on this graph.

July hogs also appear to be sufficiently overvalued to justify a short position, but in order to win in that game I have to accurately predict what the CME Lean Hog Index will do within the next eight trading days. My guess is that next week's average will be close to $80 per cwt, but—call me paranoid—the final trading days are an insider's playground and subject to manipulation. I am not a member of the club.

As a backdrop, I have a preference for the short side because the cash hog market has just recently peaked for the year and will move consistently downward from here. We are left to guess how long this incipient downtrend will last, and how far it will extend. It is much easier to be short than long when the cash market is losing ground nearly every day. The problem is that I don't see anything on the board that is materially overpriced—and therefore a candidate for a short-side play—except for the July contract.

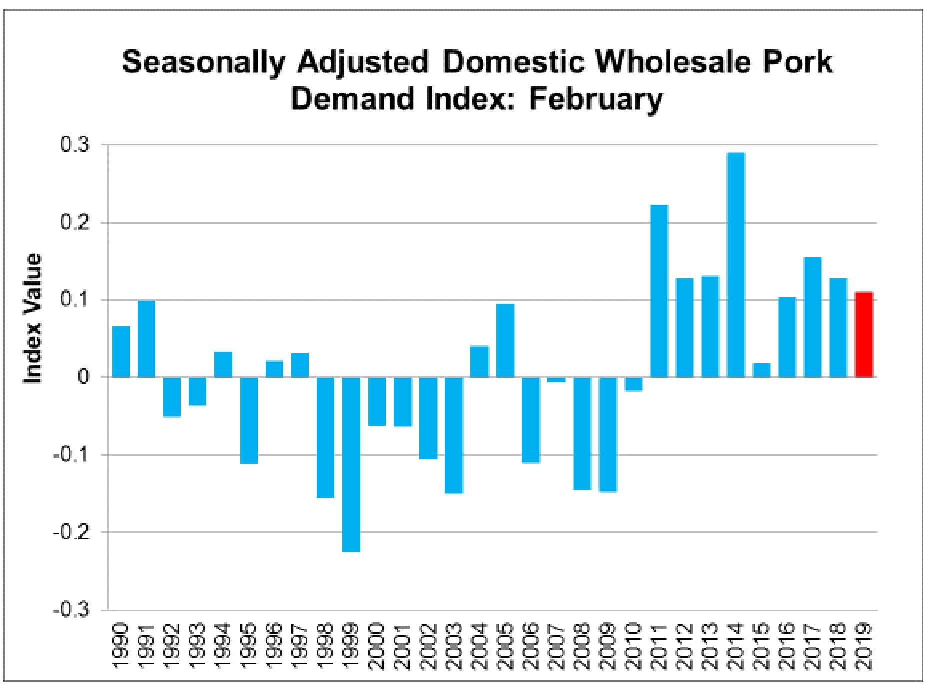
In order to render the August contract "sufficiently overvalued", it would have to rally at least 400 points from today's close. That would place it in the neighborhood of $80.00, which is really not very far away. There is no major resistance on the daily chart between yesterday's high ($77.17) and $80.00, and the futures market has been swinging wildly ever since the *Hogs and Pigs* report was released. A sale of August hogs near $80.00 would present a profit opportunity of 450-500 points and a risk of 100-150….an acceptable ratio in my book.

Applying the same logic, if October hogs are ultimately worth $61 per cwt, then they would probably need to trade up to around $66 in order to pique my interest. That happens to be an obviously major resistance level on the daily chart. I don't expect it to get there, but I do notice that a gap remains on the October chart at $67.35. Who knows?

OK, so what about the February contract? Well, if I take the summer farrowing intentions at face value and assume a typical relationship between hog slaughter in February and the rest of the first quarter, I come up with an average weekly kill of 2,438,000 for that month. If carcass weights follow a seasonally normal path between now and then, they will be about two pounds lighter than a year earlier in February, at 212 pounds. Together, these variables would place pork production at 516.6 pound per week, less than 1% above a year earlier.

Beyond production, the net domestic pork supply will depend on imports, exports, and cold storage stocks. Taking as many known factors into consideration as I can and "playing it safe" with the rest, I insert into the formula a net increase in freezer stocks of 23 million pounds during February vs. an increase of 28.9 million a year earlier; U.S. pork imports that practically match those of a year earlier at 90 million pounds; and pork exports that exceed a year earlier by 1.3% at 497 million pounds. Of course, there will always be room for adjustment in the export projections. The current projection assumes year-over-year increases in shipments to Mexico, Korea, Australia, and Colombia, and decreases in shipments to Japan, Canada, and China. [Let's come back to this topic in a minute.] That leaves the net domestic pork supply 1.0% above a year earlier in February.

Finally, I include a rather benign assumption regarding wholesale pork demand. I'll have to use a graph to show you exactly what I mean by "benign".



This supply and demand combination points to a pork cutout value of $77.50 per cwt. With respect to packer margins, my assumption is that gross margins in February will be a shade wider than a year earlier, $13 per cwt vs. $11.51. The year-over-year increase in the hog supply should just about match the increase in slaughter capacity. Adding a $5 per cwt drop credit to the $77.50 cutout value and subtracting a packer margin of $13 brings us to a CME Lean Hog Index of $69.50 in February.

I am not serious about buying February hogs just yet, because they will have to fight a lot of bearish news from the cash market for the next several months, and there is no theoretical limit on the discount that February futures can carry in the meantime. When I *do* get serious about placing a bet, I will run the battery of contingency tests under more bearish assumptions regarding each parameter.

I have not yet tied together all of these parameters for the month of April just yet, but I find it strange that the futures market has decided to price the April contract $12.50 above the price at which the April 2018 contract expired. I bring this up now because a long February/short April spread *may* have some merit, even here in July….

Forecasts:

	Jul*	Aug	Sep*	Oct	Nov*	Dec*
Avg Weekly Hog Sltr	2,190,000	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	2,127,000	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	$86.25	$82.00	$76.50	$74.50	$72.50	$74.50
Year Ago	$103.48	$91.67	$77.89	$74.51	$81.18	$79.14
CME Lean Hog Index	$79.50	$75.50	$63.50	$61.50	$57.50	$59.50
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.