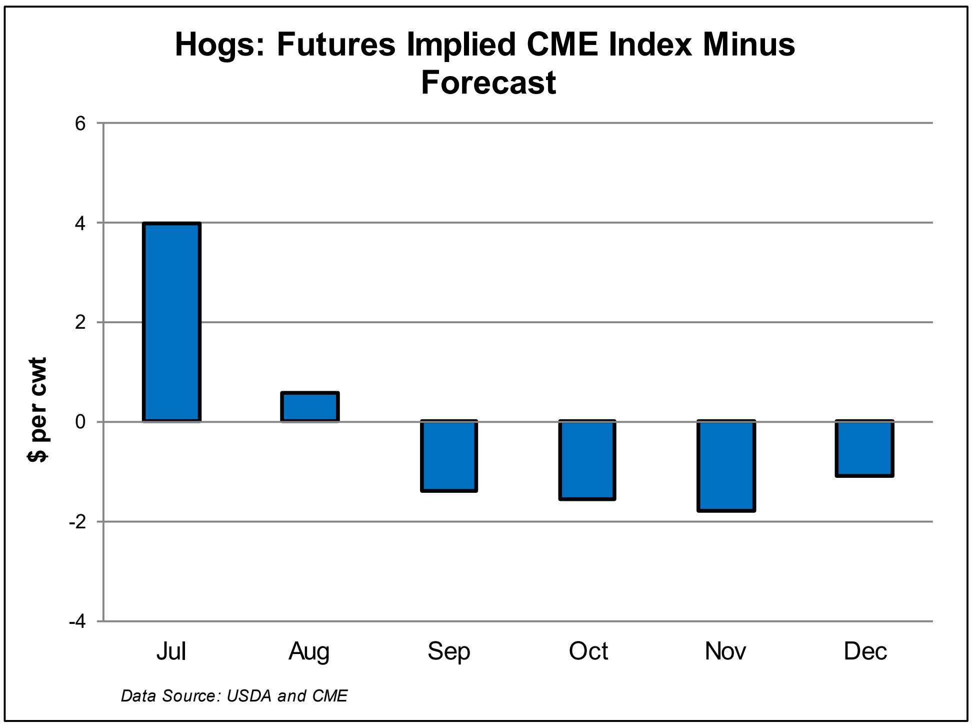
Trading Hogs

…. from a meat market perspective

A commentary by Kevin Bost

July 5, 2021



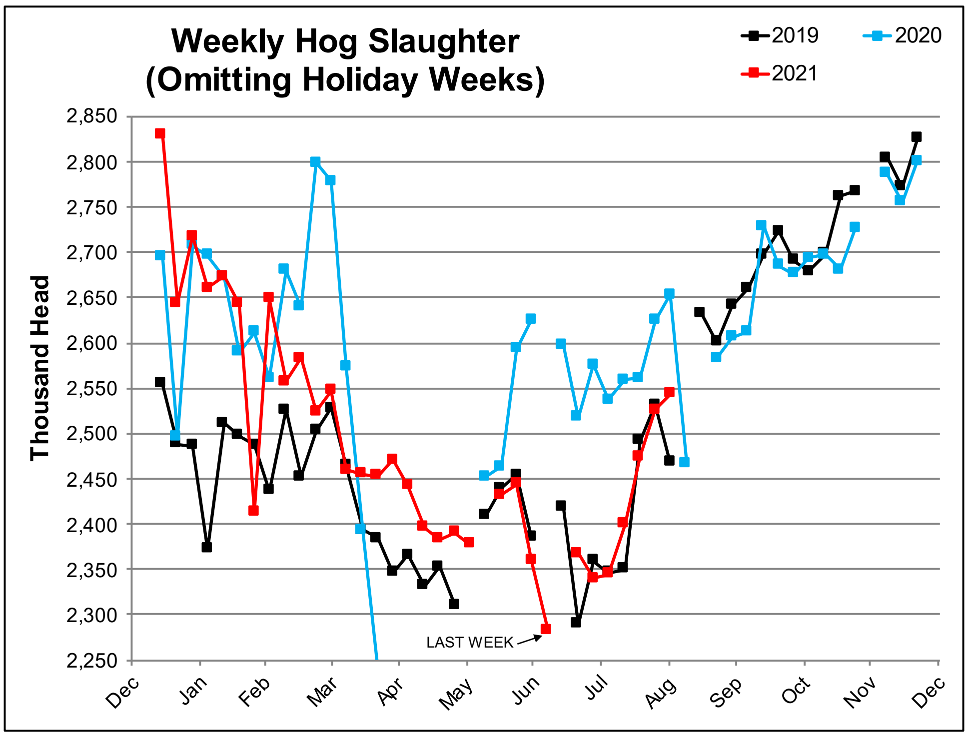
I hold a very modest short position in August hogs with a downside objective of $95.50. Last week's plan to scale into the short side from $105 all the way up to $111.70 per cwt didn't get very far. But we're not done yet, and this plan remains essentially intact.

First, though, I should explain the $95.50 objective. My best assessment of fair value places the August contract between $97 and $98. My target would be somewhere within that range, were it not for the fact that managed money traders still hold a pretty sizeable long position in hog futures; the remaining potential long liquidation, along with the downward momentum in the cash market, seem to create a decent chance that the June 24 low of $96.50 will be taken out at some point. If this happens, then the nearest support level will be $95.00.

As I mentioned a minute ago, I still plan to be a scale-up seller. There are two gaps above the market on the daily chart, one at $111.70 and another at $116.25. I doubt that either will be filled, now that both lie above the current CME Lean Hog Index (which I am guessing is between $110 and $110.50 per cwt. But I want to be ready and able to sell aggressively at $111.70 if the opportunity arises. This market is certainly volatile enough to make it happen for no particular reason.

Along with the open gaps on the daily chart, there is now a rather obvious resistance level at $105.60, and a second, less conspicuous resistance level at $106.70 (which is significant because it stopped a 300-point rally on June 22). A 50% retracement of the entire leg down would be marked at $108.52. I intend to expand my position at any or all of these points.

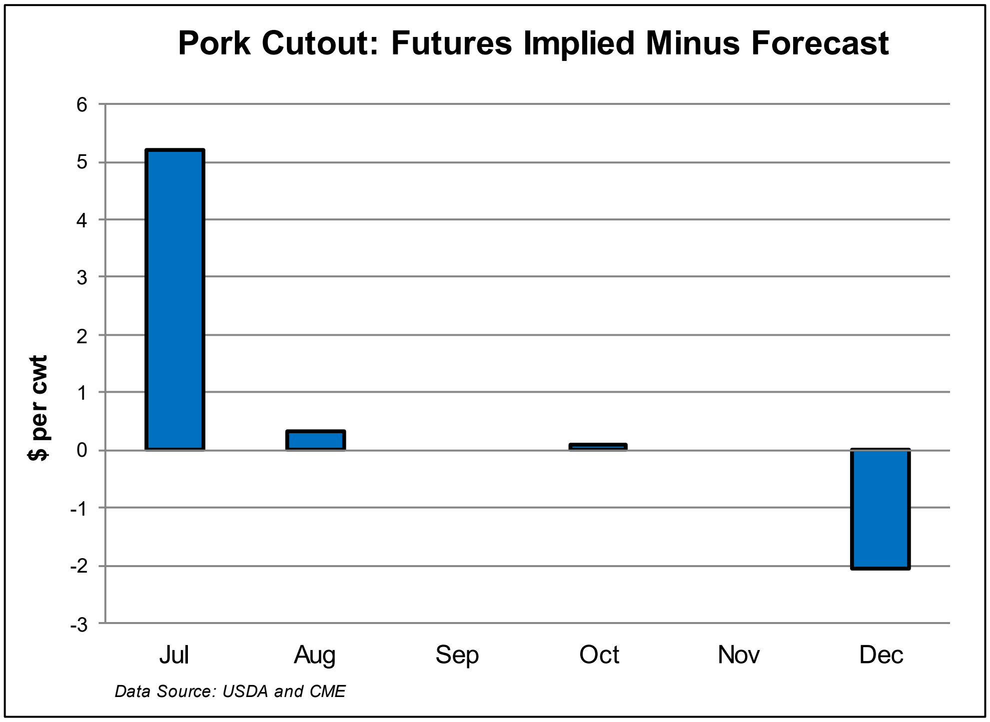
The factor with the greatest potential to derail my forecast and turn my bearish strategy into a loser is the hog supply—namely, a rate of hog slaughter that is substantially smaller than indicated by the winter pig crop. Although there is no hard evidence that this is a real threat, I must say that the size of the kills in the last two weeks—2,359,000 and 2,282,000—surprised me enough to warrant a small downward adjustment in the slaughter projections for July:



If wholesale pork demand follows a typical seasonal path from now through the end of August (after taking a big step downward in the last couple of weeks), then the slaughter projections I'm showing in the picture to the left would make for a sideways trend in the cutout value through July, averaging near $110 per cwt. The next leg downward would begin in early August. At the same time, the gross packer margin index is likely to widen, from $10 per cwt last week to $14 by the end of July and to $15 in mid-August—that is, if continues to track $2-3 above the 2012-2019 average, as it has for the past three months. Under this scenario, the CME Lean Hog Index would continue its downward trend.

The picture on the first page suggests that the July contract might be $4 overvalued with just eight trading days remaining before it expires. Really? Well, maybe not, but my most objective guess is that in the week ending July 17, the CME Index should average around $105.

I will not sell July Lean Hogs because I am already short of the August contract. However, I do intend to sell the July cutout value contract at $115 tomorrow. This one settles over the five-day period beginning this Friday (July 9) and ending the following Thursday (July 15). Friday's cash cutout value quote was $115.19 per cwt, and my guess is that it should average $110 in the week ending July 17. The greatest upside risk to the cutout value in the near term is probably the ham quote, and the 23-27-pound bone-in hams are fresh from a 13¢ rally; meanwhile, butts, spareribs, and lean trimmings should be distinctly lower. As for the loin and belly composites, I would have to call these two a toss-up.



Forecasts:

	Jul*	Aug	Sep*	Oct	Nov*	Dec*
Avg Weekly Hog Sltr	2,294,000	2,487,000	2,516,000	2,640,000	2,601,000	2,454,000
Year Ago	2,453,300	2,599,400	2,521,200	2,695,800	2,611,300	2,446,000
Avg Weekly Barrow & Gilt Sltr	2,230,000	2,420,000	2,450,000	2,575,000	2,535,000	2,390,000
Year Ago	2,386,700	2,528,400	2,452,400	2,627,100	2,546,100	2,381,300
Avg Weekly Sow Sltr	58,000	60,000	59,000	59,000	59,000	58,000
Year Ago	61,300	65,300	63,100	62,700	59,600	59,300
Cutout Value	$110.50	$105.50	$99.50	$97.50	$92.50	$93.00
Year Ago	$67.44	$72.11	$84.90	$94.11	$81.10	$74.93
CME Lean Hog Index	$104.50	$97.00	$87.00	$86.50	$79.00	$80.00
Year Ago	$48.27	$54.81	$68.39	$77.37	$69.51	$63.39

**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.