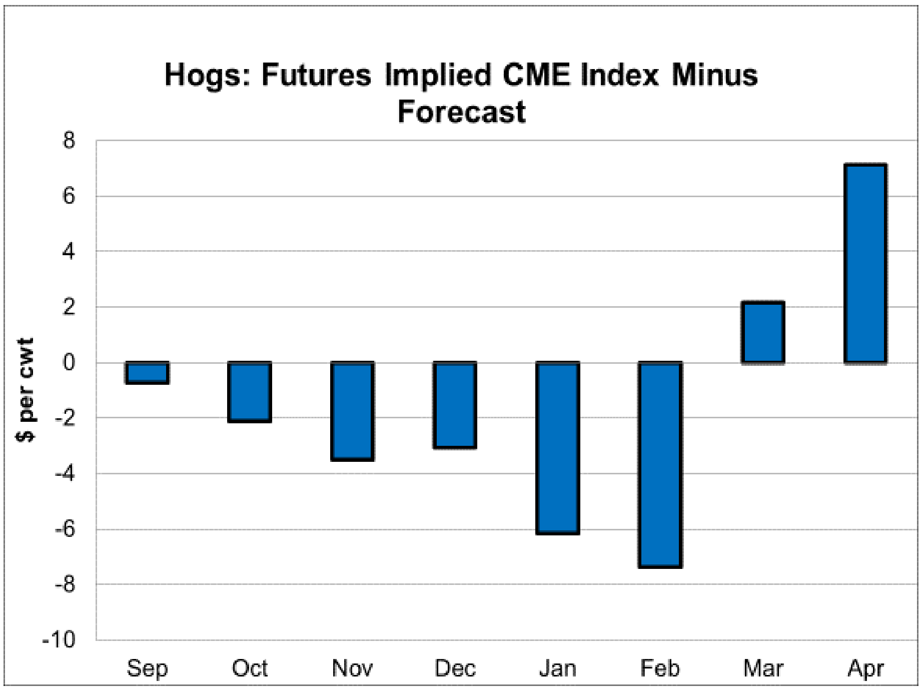
Trading Hogs
…. from a meat market perspective
A commentary by Kevin Bost

August 24, 2018



The heightened volatility in prices and spreads is presenting good trading opportunities for those who are able to be right about the market *today.* Unfortunately, that is not my strong suit. Being a "plodder" trying to profit from disparities between futures prices and longer-term economic value, it is difficult for me to find a suitable place to bet my money at the moment. Quite frankly, I do not have a lot of confidence in my forecasts right now—particularly in regard to pork demand and packer margins.

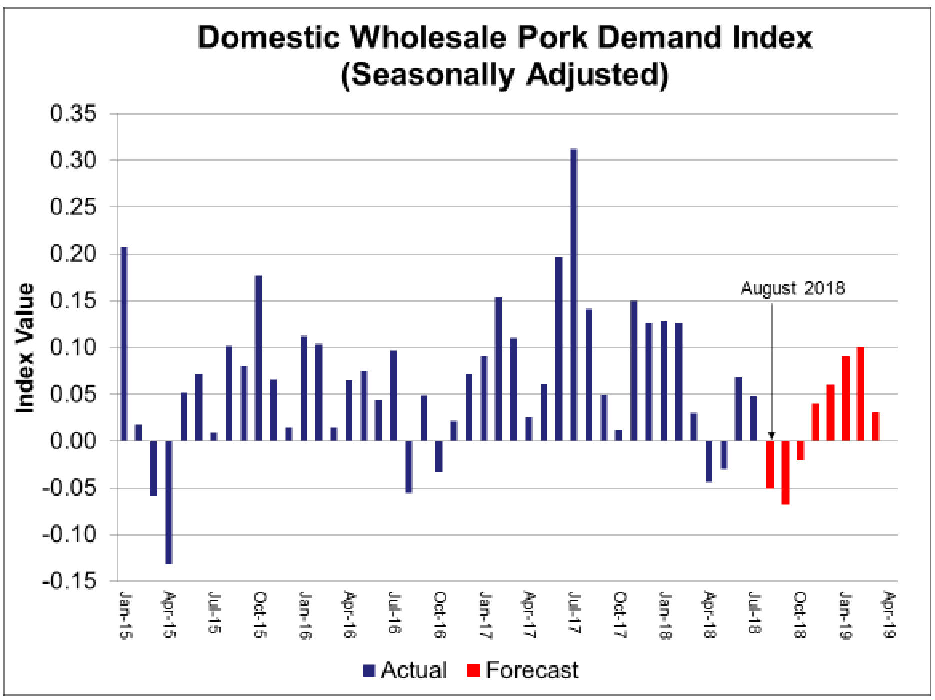
The proliferation of African Swine Fever in China launches us into uncharted waters, which doesn't make the task any easier. Relating to this development, the only thing I am pretty sure of is that the market impact—however great or small it may turn out to be—is bullish only in the long run, and probably will not affect the value of the October contract. Of course, I don't really know how to define "long run". But the bullish possibilities are dangerous enough to make me want to avoid the short side of any 2019 contracts. And so, even though April hogs appear to be substantially overvalued in the case that the Chinese hog herd is *not* destined for a massive reduction, I have no interest in selling it.

The February contract still looks like a good candidate for a long position. The huge rally that took place late last week has, of course, solidified the notion that the ultimate bottom has been established. Now it matter of guessing how closely to that bottom I will be able to buy it.

I consider the major support in this market to be $54.67, which was the top end of the big outside range on August 9, the day on which the bottom (presumably) was established. It seems like a long way from this morning's trade levels, but there is really not much in the way of support between $57.00 and $54.67….and there is a gap on the daily chart at $56.57, which always makes for an inviting target. At this juncture, the odds of a trade back below $55.00 appear to be decent, mainly because of the further downside potential in the cash market.

On that subject, I think there is a good chance that the CME Lean Hog Index will hit bottom soon after Labor Day. But that is still almost two weeks away, and the Index (which stands in the neighborhood of $47.60 for today's kill, as best I can tell) has been losing ground at a much faster pace than I had anticipated--$.70 per cwt per day over the last five days. I keep in mind also that the biggest jump in hog supplies still lies ahead. The biggest weekly kill we have seen so far this summer has been 2,451,000, and USDA's pig crop estimates suggest that kills will approach 2,600,000 in September. Obviously, demand would have to improve quite a bit by then in order to preclude another leg downward in the cutout value.

My forecast of a $52.50 average CME Lean Hog Index in November assumes that wholesale pork demand will recover substantially from its current reading, as I show in the picture below:



It is a reasonable assumption, considering how low the demand index stands right now, and that it is due for a cyclical upturn; and considering that cheap pork prices *should* buy some demand for fall deliveries. But what if the demand index were to remain right where it is today—i.e., what if demand were to merely undergo normal seasonal changes from this point forward? In that case, we would be looking at a cutout value of about $61 in November….and with current packer margins, a CME Index of $46.

That brings up another question. Gross packer margins have already widened to points not expected to be seen until their November peak….if even *then*. Who's to say that they will not widen further? Over the last five years, packer margins widened by an average of $7.50 per cwt from the second half of August to their November peak. It's fair to say that to some degree, the market is depending on a material addition to slaughter capacity by October. What if those plans are delayed?

And so I will wait for February hogs to drop below $55.00 before I place a bet. I will raise that target as soon as either the cash market or the futures market tells me that I have to.

Forecasts:

	Sep*	Oct	Nov*	Dec*	Jan*	Feb
Avg Weekly Hog Sltr	2,506,000	2,572,000	2,568,000	2,487,000	2,454,000	2,438,000
Year Ago	2,420,500	2,503,700	2,422,100	2,420,500	2,339,270	2,396,090
Avg Weekly Barrow & Gilt Sltr	2,440,000	2,505,000	2,500,000	2,420,000	2,385,000	2,370,000
Year Ago	2,357,500	2,436,800	2,357,600	2,356,000	2,273,500	2,330,170
Avg Weekly Sow Sltr	58,000	59,000	60,000	59,000	61,000	61,000
Year Ago	55,500	59,300	57,300	56,800	57,620	58,640
Cutout Value	$64.50	$68.50	$68.50	$70.00	$73.50	$74.50
Year Ago	$77.89	$74.51	$81.18	$79.14	$80.74	$78.04
CME Lean Hog Index	$49.00	$53.25	$52.50	$54.00	$64.00	$67.50
Year Ago	$62.02	$61.73	$65.88	$63.28	$70.97	$71.61

**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.