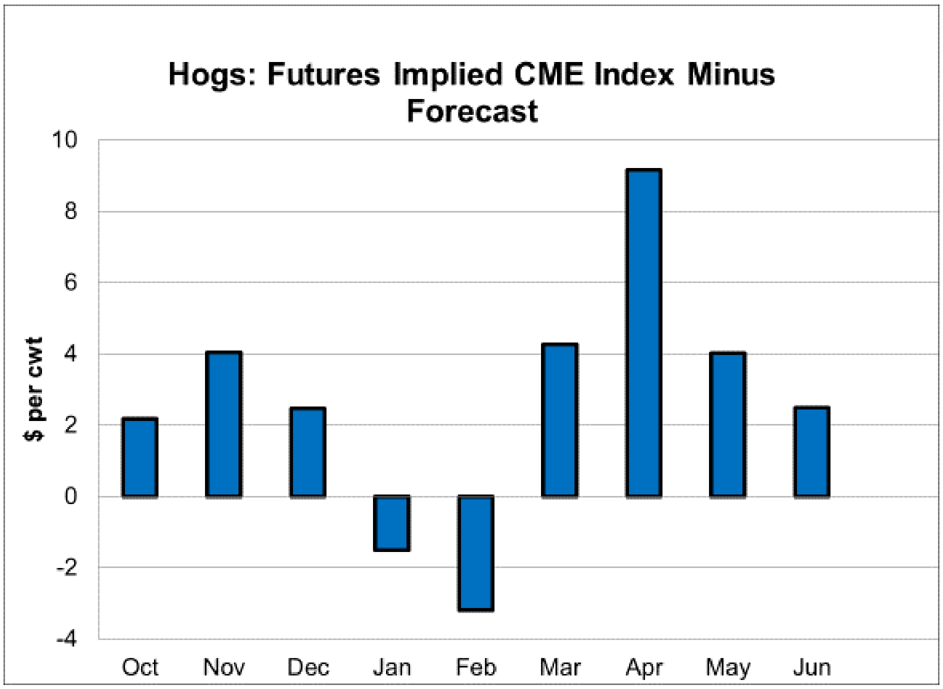
Trading Hogs
…. from a meat market perspective

A commentary by Kevin Bost

September 16, 2018



I closed out the long October / short December spread on Friday, because the cash hog market showed a faint sign of weakness after a $9.50 rally in the CME Lean Hog Index. The index itself has not yet turned downward, but Friday's report of negotiated prices showed a decline of $.30 per cwt—normally not a significant change, but this past week's very short kill certainly has backed up a fair amount of hogs that presumably will be forced into the supply chain over the next few weeks. I suspect that a softer cash market would not be favorable to the bull spreads, especially as African Swine Fever proliferates. On that subject, I also suspect that the disease is spreading faster than official Chinese reports suggest, which is generally bullish of the more deferred futures contracts.

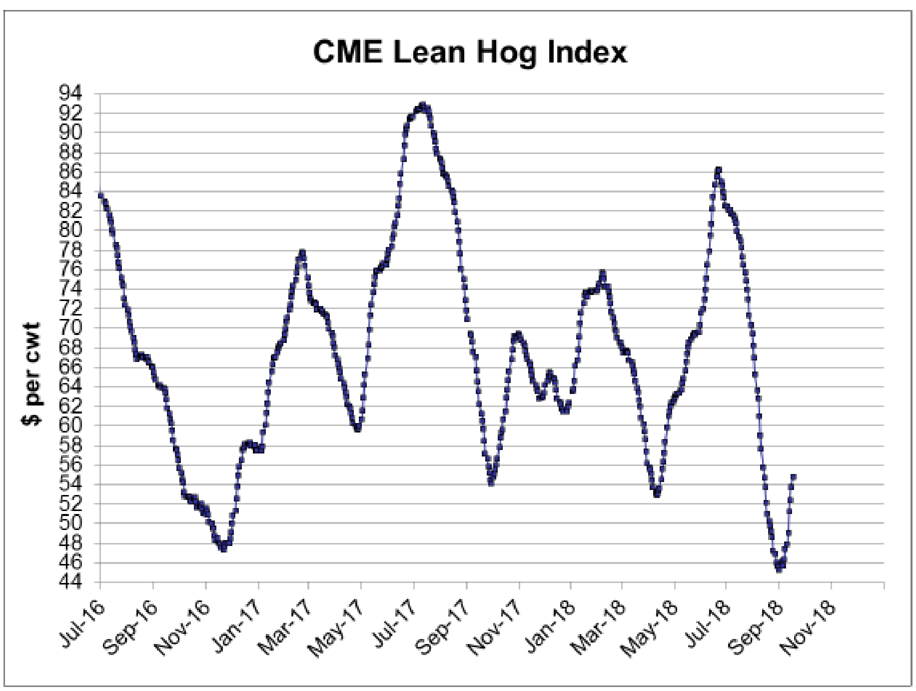
A good portion of the strength in the pork cutout value over the past week likely was due to the temporary shutdown of the Smithfield plants in Tar Heel and Clinton, North Carolina (with combined capacity of approximately 45,000 hogs per day). It stands to reason, then, that the cutout value will now fall back as production resumes. It also stands to reason that spot packer margins will remain wider over the next couple of weeks than they would have otherwise, as the backlog of hog supplies is absorbed.

Of course, it's not easy to predict how prices will respond to the disrupted production, but I assume that the adjustments will be temporary; ultimately, prices will seek out the equilibrium that would have prevailed in the absence of the tropical storm. But the across-the-board rally in pork prices that we have seen so far will *not* affect demand down the road; the demand-side momentum has been bulding for too long to be deterred by one week of sharply higher prices.

I am approaching the hog market more cautiously than usual at this point, because my assumptions regarding all three major elements in the pricing equation—hog slaughter, wholesale pork demand, and packer margins—are quite fragile. Frankly, I do not have a lot of confidence in the cash price forecasts shown in the table below. I would do well to keep this in mind as I reach into my pocket. I am downplaying the relevance of seasonal price history in the near term, since supply and demand factors will remain out of balance for a while and until that balance is restored, prices could make some unusual moves.

But there are a few entries on the card that pique my interest. One is my longstanding assessment that the February contract is ultimately worth something in the upper $60's per cwt. This is based on the notion that the cutout value in February—without any major surge in U.S. pork exports—will average $76.50 per cwt (vs. Friday's quote of $74.53); that hog slaughter will be 2% above a year earlier, at 2,440,000 per week; and that gross packer margins will center around $12.50 per cwt (vs. this past week's average of $24.83, and $11.51 in February 2017). However, it's fairly likely that there will be a period of sub-$50 CME Index values in November (just how far "sub", I don't know), and that could drag the February contract down to its nearest major support level of $59.50, and perhaps even to its next level of major support at $54.50. The latter probably would be within reach only if the news regarding African Swine Fever goes silent.

Another short-term play that I am considering is the short December/long February spread. It appears to have some fundamental merit based on my humble assessment of ultimate value, but more so on the prospect of a setback in the cash hog market. Currently the February contract holds a premium of about $9.50 per cwt, which is extremely high by historical standards and therefore dampens my enthusiasm for this trade. But if it should draw in to $7.50—which could happen if the December contract were to make another leg up to $60-plus—then I would be willing to place a small bet, risking two closes within $6.50 and expecting a return to the recent high of $11.25.



Forecasts:

	Sep*	Oct	Nov*	Dec*	Jan*	Feb
Avg Weekly Hog Sltr	2,428,000	2,582,000	2,563,000	2,477,000	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	2,362,000	2,515,000	2,495,000	2,410,000	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	$71.50	$69.50	$68.00	$70.50	$74.00	$76.00
Year Ago	$77.89	$74.51	$81.18	$79.14	$80.74	$78.04
CME Lean Hog Index	$51.75	$54.00	$50.50	$54.00	$65.00	$69.00
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.