Trading Cattle
…. from a meat market perspective

A commentary by Kevin Bost

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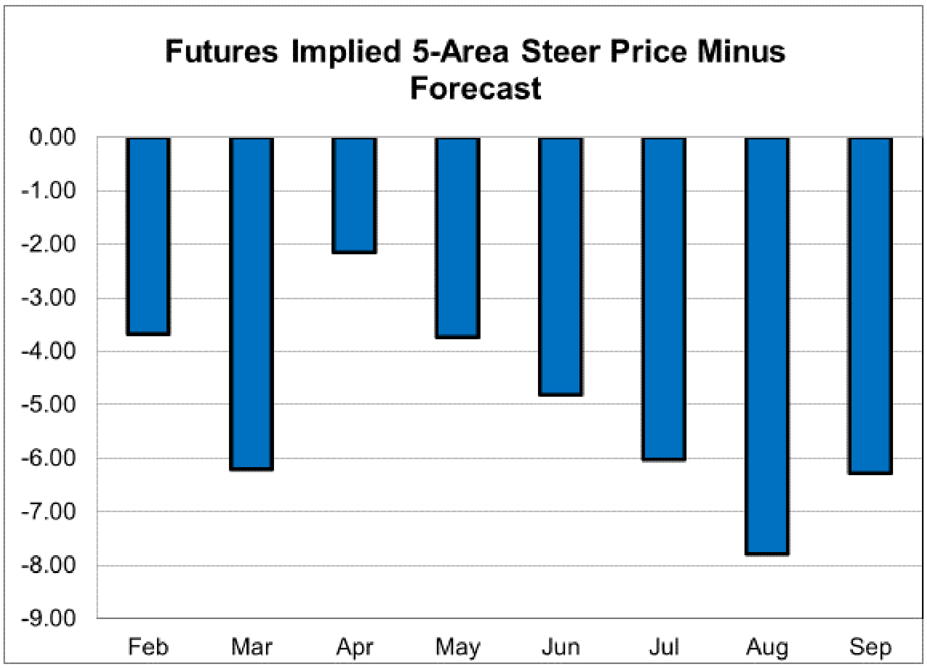

I remain modestly short of the April/August spread, with a tentative target of $11.50 (premium to the April contract). I call it a "tentative target" because there is reason to give it some room, for two reasons: one is that from a fundamental standpoint, the ultimate values of the two contracts appear to be only about $7 apart; the other is that the whole market is technically vulnerable to a further, sizeable break, in which case the bear spreads presumably would be favored. I think I can afford to be patient because the near-term trend in the April premium has turned downward. There is nothing magic about $11.50; it is simply the nearest major support level on the chart.

My keener interest is in the long side of the August contract, for reasons that should be obvious from the picture above. My grandiose plans are to build an aggressive position, but that project will not begin today. My sights are, at least for the moment, set on sights that are much lower than the market trades this morning.

Right or wrong, the market's current behavior is bearish. In the April contract, the five-day moving average has dropped below the ten-day MA, and the ten-day MA lies below the 40-day MA. This is not a very positive picture. The long position held by large speculators in the cattle market is not what I would call huge, but it is among the largest of the last two years; and so there is a substantial amount of potential long-side liquidation on deck.

Digging more deeply into my treasure of technical wizardry, I notice that in the April contract, there is not much in the way of support between $112.75 and about $109.75. I notice that a duplication of the first leg downward (from $120.32 to 112.75) would measure to about $109.10. And I notice that a 50% retracement of the entire rally from $97.25 to $120.32 would measure to $108.80. The 100-day moving average stands at $109.70. Since these price objectives all appear to be far undervalued from a fundamental standpoint, I have to regard them as likely places for a major bottom.

As for the August contract, a duplication of the first leg down (from $105.00 on January 19 to $99.40 on February 1) would measure to $96.80, and a 50% retracement of the entire rally from the contract lows would be to $97.45. The 100-day moving average stands at $98.05. Thus the $97.00-$98.00 range is where I have targeted for my first bet.

Assuming that the market does indeed succumb to the near-term technical, downward forces, my choice is then whether to effect the long August position by lifting the short leg of the April/August spread, or by retaining the spread and adding an incremental long position in the August contract. I am leaning toward the former, if the April can be bought in the neighborhood of $109.

I intend to buy into a declining market in this case because the August contract appears to be vastly undervalued. If I am correct in this assessment, then this is probably not the beginning of a new, long-term downtrend; it is a major correction in a market that is ultimately headed higher, at least as far as the August contract is concerned. The June contract should be destined for a match of its January high (we'll call it $109).

A further note on the June contract: there is such a conspicuous support level at $103.25 that a close below that level would have to be portentous, would it not? I am not a short-term trader, and the undervalued condition of June cattle would normally preclude me from selling anything at this price level. But as I have stated before, if the technical signals are compelling enough, I will make a rare exception. In this case, I see nothing that would prevent a close below $103.25 from leading to a move down to about $101.00.

In the near term, the developments in the cash market should be stable, if not bullish. As best I can tell, the beef market will begin to work its way upward this week, and the higher trend will persist for about four weeks. I feebly expect that packer margins will recover in the meantime, such that cash cattle prices hold basically steady. But even this scenario would not be bearish of the futures market, because of the already-existing discounts. On that subject, I notice that the current discount of April futures to the cash cattle market is the second-steepest of the last 15 years for the third week in February; and the discount in the August contract is—by some measure—the steepest on modern records.

Forecasts:

	Feb	Mar	Apr	May*	Jun	Jul*
Avg Weekly Cattle Sltr	572,000	570,000	590,000	620,000	629,000	613,000
Year Ago	536,900	541,500	565,300	590,200	588,000	572,300
Avg Weekly Steer & Heifer Sltr	452,000	454,000	473,000	503,000	514,000	500,000
Year Ago	422,600	431,300	454,200	479,600	480,100	466,900
Avg Weekly Cow Sltr	111,000	107,000	107,000	107,000	105,000	103,000
Year Ago	106,700	101,600	101,300	100,700	97,600	95,500
Steer Carcass Weights	883	874	864	862	869	882
Year Ago	890.8	890.0	874	861.5	865.4	879.5
Avg Weekly Beef Prodn	467	464	475	499	509	500
Year Ago	442.9	448.9	461.4	477.0	476.9	468.5

Avg Cutout Value	$191.00	$196.50	$194.50	$197.00	$195.00	$184.50
Year Ago	$215.57	$220.62	$214.70	$210.80	$210.83	$198.95
5-Area Steers	$119.50	$120.00	$116.00	$116.00	$113.00	$108.00
Year Ago	$133.91	$136.56	$129.53	$128.72	$123.34	$117.17

**Includes holiday-shortened weeks*

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