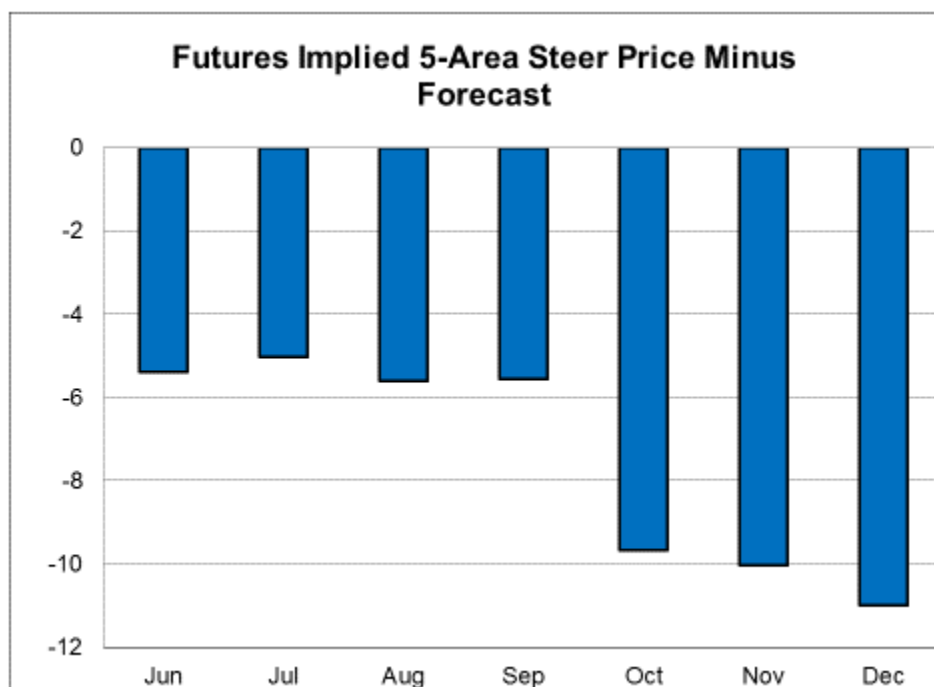


Trading Cattle

....from a meat market perspective

A commentary by Kevin Bost

May 20, 2016



Yesterday was one of those days on which I started to explain my perspective, and then had to erase the blackboard and start all over again.

I am moderately long of the June contract, and I am short of the June \$120 puts, which expire in two weeks. I recognize that

the upside potential is greater in the October and December contracts, but the nearby probably has a more solid floor underneath.

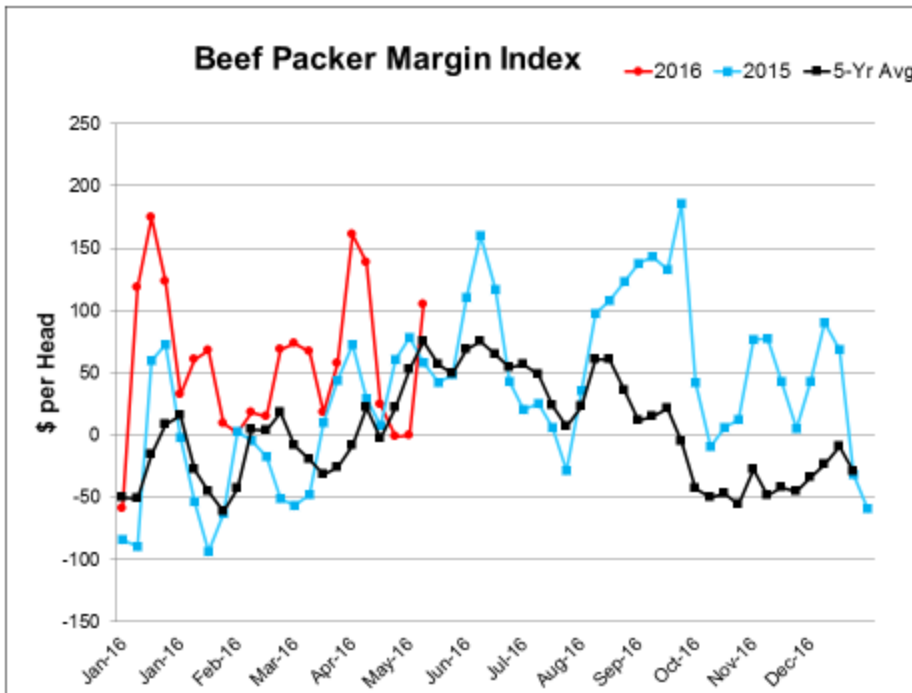
Most unsettling to me is that the combined Choice/Select cutout value has hit a ceiling at a significant resistance level (\$221 per cwt), and likely will move lower into the second or third week of June. This is pretty much as I had anticipated. Yet, being a Meat Guy, I am always uncomfortable having my money bet on the long side of the table when the cutout value is headed downward, even if the decline is not expected to be great. With this in mind, and in view of the recent price action, I am willing to step aside temporarily if June cattle rally back to \$122.50 (or thereabouts). However, even leaning toward the conservative side of center of probability, it still appears that the June contract is ultimately worth \$125.00-\$127.00. When you stop laughing, allow me to explain my rationale.

Here in the third week of May, the discount in June futures is record wide and pretty close to a year ago at this time. Last year, the discount in the first two weeks of June averaged about \$1.00 per cwt. The widest discount during that period was \$6 in 2014, and the second-widest occurred in 2003 at about \$3.50. In the second half of June, the widest discounts have been \$2.00-\$2.50. Under the circumstances, it might be reasonable to expect something near these record levels.

OK, so from what point will those discounts be measured? To begin with, there does not seem to be a good reason to expect a deterioration in wholesale beef demand until after Independence Day. As I have mentioned quite often recently, a preponderance of June deliveries have already

been completed, and the forward booking volumes have been pretty healthy. Thus, it is unlikely that the the pullback in cutout values between now and mid-June will be as extensive as the board is assuming.....and it is likely that they will recover from that point into the end of June. This would be terribly unusual; in fact, it has happened in four of the past eight years (in the other four years, they held steady). My guess is that the combined cutout value will find its next low point just above \$210 per cwt, and finish the month of June around \$216.

There has been quite a bit of fluctuation in packer margins, but the spot margin “index”—which is simply a comparison of spot cattle prices and cutout values, factoring in the drop credit and a representative slaughter/fabrication cost—has centered around \$95 per head since the middle of April:



At a combined cutout value of \$212 per cwt (which is about where I anticipate the next low will be on a weekly average basis), together with a packer margin index of \$120 per head (to be conservative) would align with a Five Area Weighted Average

Steer price of about \$125.50. The same margin index combined with a \$216 cutout value would place the cash cattle market at \$128. Applying the record-wide discounts described above to these cash prices would place the June futures contract at \$119.50 in the first half of June, and \$125.50 in the second half. Once again, I regard these possibilities as conservative.

Forecasts:

	May	Jun*	Jul*	Aug	Sep*	Oct
Avg Weekly Cattle Sltr	599,000	609,000	589,000	603,000	587,000	586,000
Year Ago	557,600	550,300	537,400	543,900	556,400	557,900
Avg Weekly Steer & Heifer Sltr	487,000	499,000	481,000	494,000	473,000	466,000
Year Ago	456,100	448,900	439,100	445,100	446,200	446,400
Avg Weekly Cow Sltr	101,000	100,000	98,000	100,000	103,000	109,000
Year Ago	92,800	91,900	89,400	89,500	100,000	102,100

Avg Cutout Value	\$211.50	\$214.25	\$205.50	\$206.50	\$203.00	\$205.50
Year Ago	\$254.70	\$247.01	\$237.41	\$237.93	\$224.27	\$209.31
5-Area Steers	\$129.50	\$127.50	\$124.50	\$124.00	\$123.00	\$127.00
Year Ago	\$160.51	\$152.03	\$148.63	\$148.45	\$132.61	\$132.48

**Includes holiday-shortened weeks*

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