

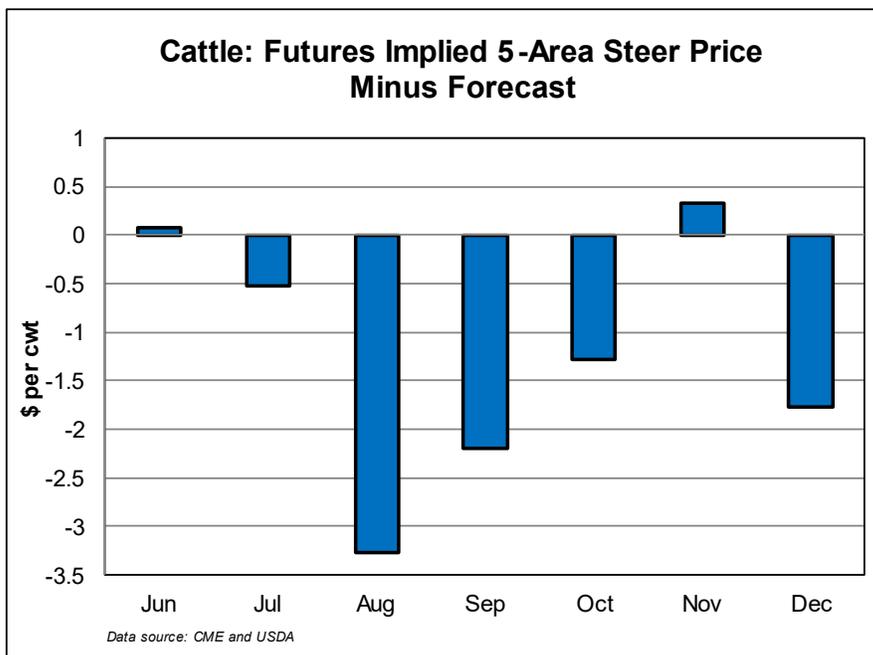
Trading Cattle

.... from a meat market perspective

A commentary by Kevin Bost

June 7, 2021

Please note: Trading Cattle will not be published next week, as I'm taking a rare week off to visit my daughter (and to catch three days of racing at Gulfstream Park, not necessarily in that order). I hope you don't mind.



I hold no stake in the cattle market at the moment. And oddly, the trading opportunity that seems nearest on the horizon is a short position in the August contract—an option that appears to be somewhat undervalued—upon a close below \$116.00. Obviously, this

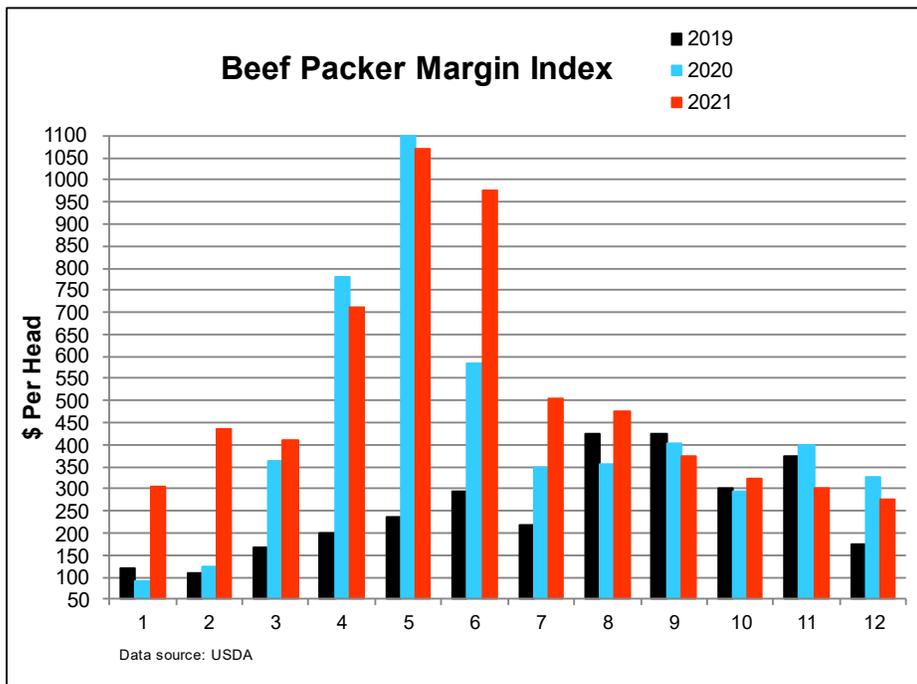
would be a purely technical play, and its appeal is exactly as I described one week ago—except for one additional quality. Last Tuesday the market plunged below that mark by 137 points, clearing out sell stops along the way....sticking its toe in the water, and then snapping back strongly. As I view it, a close below \$116.00 would now be more telling, as it would signal that the market is becoming comfortable trading below what was previously such a conspicuously major support level. That's about the extent of my technical wizardry today, except that my downside target would be the gap on the daily chart at \$109.12.

I have long thought that this gap would be so far below the ultimate value of the August contract that it had practically no chance of ever being filled. While I still think that August cattle are probably worth \$120-plus, I have to ask myself what, among the near-term fundamental considerations, would make selling August futures below \$116 such a bad idea? It's hard to come up with one.

As long as packers remain in complete control of cash cattle prices—cash cattle *quotes*, I should say—it is hard to bet against another leg downward. If cutout values are on the brink of a major “reset”, as I think they are, then it is easy to envision packers giving up some of their margin but walking the cattle market down at the same time. And if that’s the way it unfolds, then who’s to say where that process will end? \$115? \$110?

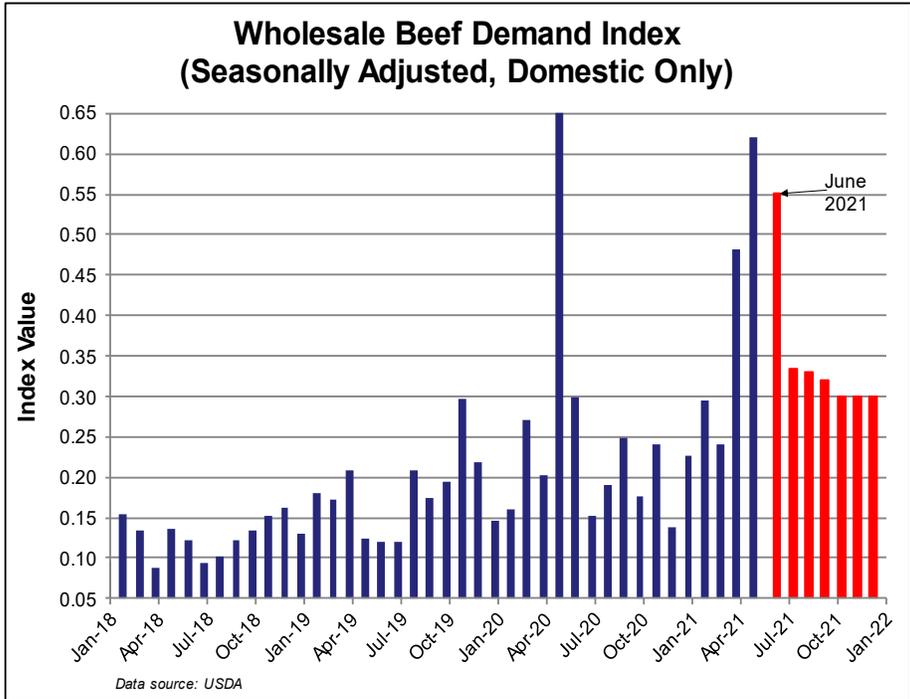
The critical point at which the green light is given to a bet from the long side of the table is when cattle feeders regain some leverage in the determination of cash cattle supplies from week to week. I don’t think we’re very close at this juncture, since it is evident that fed cattle slaughter is unable to keep up with available cattle supplies. [The temporary shutdown of JBS’ slaughter operations is only a short-term consideration, but it only added to the backlog.] But it does look as though the inventory of cattle on feed 150 days or longer will take a sizeable step downward in August, and so I’m guessing that this threshold will be reached sometime around August 1.

In any case, I have no business trading in anything more than minimal quantities at least until the volatility in packer margins and wholesale beef demand quiets down. Both of these variables are unsustainable and headed for major changes down the road, and in the meantime, they are extremely hard to project. I have to show the pictures of each yet again, just to demonstrate just how wide the range of possibilities could be for cattle prices in August.



When I look at this graph of the packer margin index, it is hard to rule out an index value as high as \$700 or \$750 per head. After all, it scored over \$1200 per head last week. On the other hand, an index

value of \$400 would seem to be in play as well, given that it averaged \$358 in August 2020 (and cattle supplies were backlogged last summer as well).



Likewise, it is hard to rule out a wholesale beef demand index somewhere in the neighborhood of its standing in May....I'm not *certain* that this consumer spending spree will let up any time soon. Yet, if there is indeed a substantial

backlash in demand from sharply higher retail prices, then why could this index not return to where it stood in March?

When I combine the full span of reasonable values for these two variables in the matrix below, it produces a ridiculously wide range of possibilities for the cash cattle market in August. Until this range can be narrowed substantially, I should play my cards close to the vest.

Cash Cattle Prices in August

		Packer Margin Index			
		\$700	\$600	\$475	\$400
Demand Index	.50	\$124.00	\$131.50	\$140.50	\$146.50
	.37	\$109.00	\$116.50	\$125.50	\$131.00
	.33	\$104.50	\$112.00	\$121.00	\$126.50
	.24	\$94.00	\$101.50	\$110.50	\$116.00

Forecasts:

	Jun*	Jul*	Aug	Sep*	Oct	Nov*
Avg Weekly Cattle Sltr	641,000	631,000	645,000	634,000	639,000	636,000
Year Ago	645,700	630,500	645,300	636,500	645,000	634,600
Avg Weekly Steer & Heifer Sltr	509,000	504,000	513,000	500,000	499,000	498,000
Year Ago	513,500	508,700	520,600	506,200	507,700	499,100
Avg Weekly Cow Sltr	120,000	116,000	120,000	122,000	129,000	128,000
Year Ago	120,600	111,200	113,400	119,000	126,300	125,700
Steer Carcass Weights	896	910	922	934	941	942
Year Ago	893.5	901.0	910.3	921.0	928.5	924.5
Avg Weekly Beef Prodn	528	526	542	537	542	541
Year Ago	534.3	524.0	537.9	534.3	542.5	532.7
Avg Cutout Value	\$300.00	\$245.00	\$247.00	\$238.00	\$234.00	\$235.00
Year Ago	\$240.10	\$201.66	\$214.29	\$218.06	\$208.35	\$224.87
5-Area Steers	\$117.50	\$117.50	\$121.00	\$123.00	\$124.00	\$126.50
Year Ago	\$103.46	\$96.62	\$104.52	\$104.01	\$106.27	\$108.94

*Includes holiday-shortened weeks

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