

Livestock Market Outlook and Thoughts on Price Risk Management  
December 9, 2022  
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Not much has changed in livestock prices since our October update beyond continued volatility. We'll address that below, after addressing what has changed, which is a continued trend toward less North American production – **Toward**, but not there yet for beef. We'll start with the market fundamentals.

**Beef**

The beef market got another hint of what is to come in early December when USDA released both their monthly Cattle on Feed report as well as their July 1 inventory estimates. Cattle on feed were down 2% with new placements down 6.1%. These compare to market analyst expectations of declines of 1.7% and 3.5%.

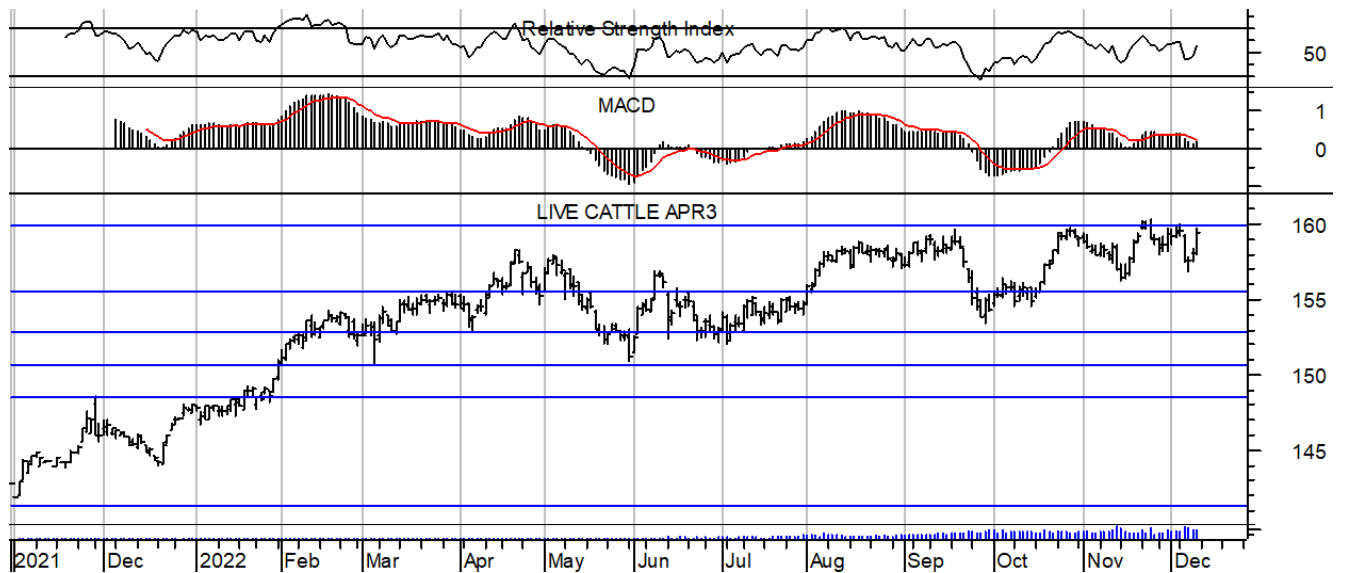
July 1 Inventory revealed that in the US, total inventory of beef cattle was down 2%, including 2.4% fewer beef cows, and 3.5% fewer heifers for breeding. There were also 2.7% fewer calves. Canadian numbers were 2.8% fewer head total, 1.7% fewer beef cows, breeding heifers down 7.4%, and calves down 5.0%.

Inventory numbers started dropping in 2019 and have trended downward since. The problem, from a pricing perspective, is that in the beef industry the result of dropping your inventory is that you increase supply of beef: heifers and cows from the breeding herd go to market, offsetting any decline in numbers of steers. Beef production was higher in 2021 and projected to be higher this year.

The demand side of the market remains robust so far. As we discussed in our last update, weekly beef production has been consistently higher week over week because drought reduced the amount of forage available and because of losses to cattle feeders. Both factors induced more female marketings, keeping supply higher. Despite this, prices are higher than the same time last year. As pointed out in our last report, this indicates that demand is strong. Part of that strength is due to continued strong exports, with China leading the trend upward. This bucks the widespread expectations that the Covid issue in China would result in reduced demand. The same applies to the North American domestic market, where demand is strong despite the constant angsting that rising interest rates and the still non-existent recession will curtail demand.

April futures through December 9 reflect the discussion above.

**April 2023 Live Cattle Futures Through Dec 9, 2022**



As discussed in our last report, the market has maintained resistance at \$160 and we suggested selling just below that level. It actually traded through \$160 November 21-23, but never twice consecutively higher. Then it faded, confirming the short position. In our trading rules, the confirmation was strengthened by the divergence between the high on the Nov 23 price chart and lower values of MACD and relative strength index. Another confirmation was the bearish key reversal on the 23<sup>rd</sup>.

Until today, it appeared that the strategy was working and that the market was headed for the \$155 area, where we likely would have taken profits. However, there is a spike back up toward \$160 here on the 9<sup>th</sup> with no explanation except that cash prices are up, which has no relevance to April '23!

In our methods we would remain short unless there are two consecutively higher closes above \$160.30.

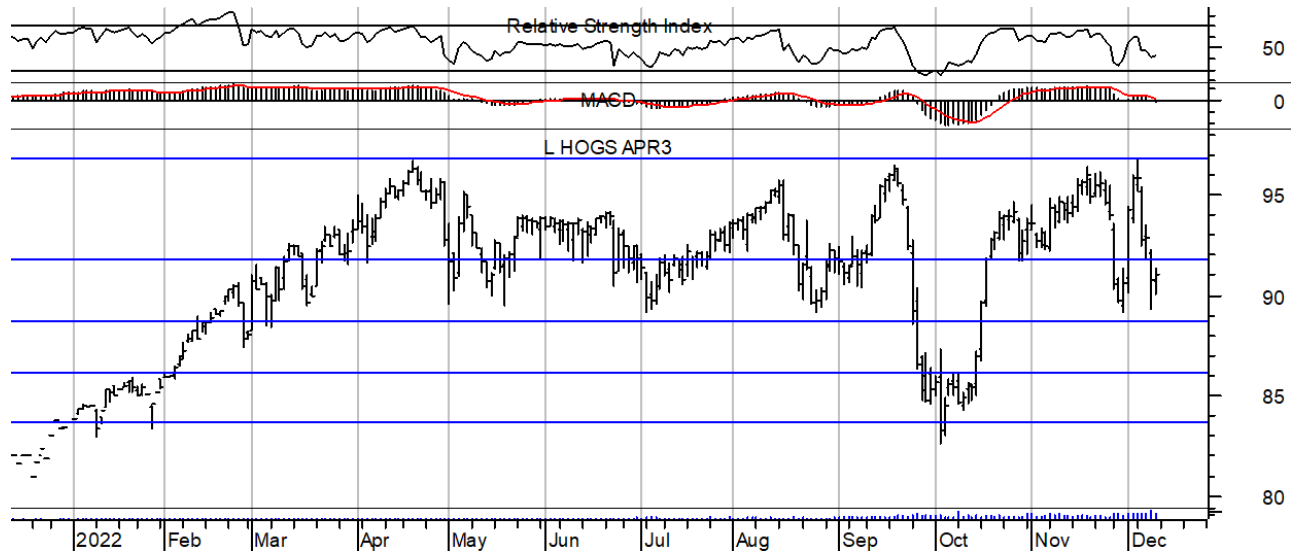
The other strategy that we discussed was to buy \$160 Puts and sell one or both of out-of-the-money Puts (maybe \$150 or \$153) or out-of-the-money Calls (likely \$170 or \$167) to offset the cost of the \$160's. Doing that requires that you understand the risks associated with writing them.

### **Pork**

Very little has changed in the fundamentals of the hog market since our last update: slaughter, consistent with the inventory data, has continued to be a little under year earlier. Exports remain down to China, where the herd is still being rebuilt following that county's ASF outbreak. Domestic demand appears to continue strong.

As the April 2023 futures chart shows. There is major resistance at \$97. Most times the market rallied to that level it fell back toward either the 23.6 or 38.2% retracement, and once all the way to the 61.8% line. the most recent time it visited the \$97 area on December 2, there was substantial bearish divergence with both the relative strength index and the MACD. Since then it moved back down almost to the 38% line. it is time to take some profit and watch for another chance.

**April '23 Lean Hog Futures, Dec 09, 2022**



Production in both countries have trended down slightly since 2020, from 2.1 to 2.0 million tonnes in Canada and from 12.8 to 12.3 million in the US. Production in 2023 is forecast to be very similar to 2022 in the US but slightly lower in Canada.

Live animal inventories are trending similar to production with the US in the 77 million head range for 2020 and 2021, declining to 74 million in 2022 and 2023. Canada hovered around 14 million head all three of 2020-22, and is projected to 13.8 in 2023.

International trade in pork can have a major impact on the domestic market, especially with China, whose swine herd is more than four times the US and is close to being self-sufficient. In 2020 and 2021, China imported 5.3 and 4.3 million tonnes of pork, dropping off to 1.8 and 1.7 projected for this year and next. Canada’s pork exports have been maintained by picking up other customers. Especially Mexico, the Philippines and Vietnam. The US is projected to fall off slightly in 22/23.

Overall, the North American pork market has performed reasonably well in spite of the drop in China’s imports and continued high domestic production. This implies, as with beef, that domestic demand is relatively strong. US prices in 2021 and ’22 are higher than the previous two years and it appears that 2022 will end up being the higher of the two.

**Where to From Here?**

USDA’s September Hogs and Pigs report confirmed another 1% decline in the breeding herd. So, going forward, excess production should not be a problem and the hog market is likely to benefit with higher prices from the likely higher beef prices – if demand doesn’t collapse.

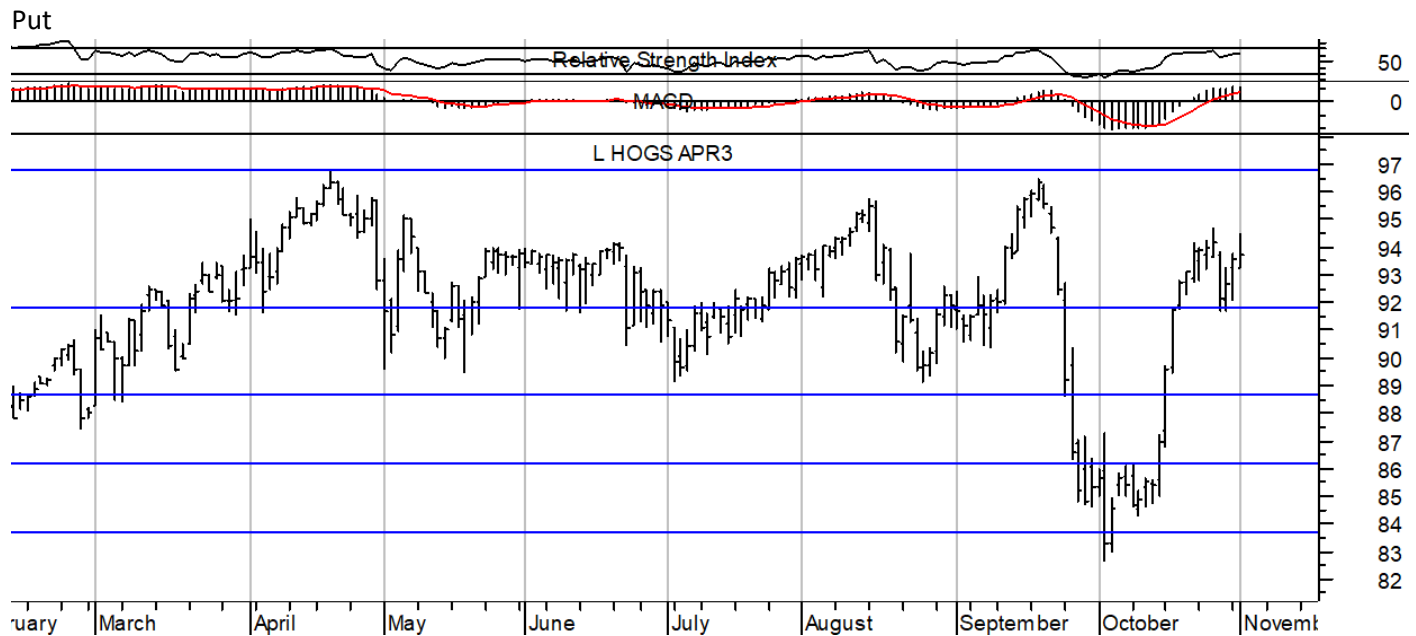
As with beef, some prognosticators have wrung hands and gnashed teeth over the prospect of declining demand. But so far, the market has always moved back toward previous tops as can be seen in the April Lean Hog futures chart below. It shows that a “feared demand collapse” occurred in mid-September when prices fell all the way from \$96 to \$84 at the 62.8% Fibonacci retracement before finding support. But it has recovered back to the \$94 area so far.

When these drops appear, the so-called “hedge funds” get scared. They have been net long futures to the tune of 65,000- 70,000 contracts on the rallies. They get scared of the demand effect, sell off their

positions to the 10,000 net long area, thereby driving prices down below cash prices. Sensible people know that futures have to coincide with cash and start to bid them back up. The funds then get optimistic again, join the band wagon, and move back to 65,000 – 70,000 net longs. Both cattle and hogs got to that area last week even with the dip at the end of the week (again taking futures below cash).

As with cattle, there are at least three approaches to managing price risk.

- As with cattle, we don't like the buy a Put/sell a Call approach because of the likelihood of higher prices.
- The buy a Put/Sell a Put strategy is more appealing, though which Put to sell is more problematic since support is at the 62.8% level.
- We like the concept of selling futures above \$95.50. Resistance back in April at \$96.50 would be the point for a close-only stop. Because of the lack of clarity about which area will provide support, this approach means watching the market carefully to decide where to take profits.



#### Reference

- USDA , *Livestock and Poultry: World Market and Trade Report* , October 12, 2022