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J.S. FERRARO & COMPANY | RETAIL READY Foods Inc.

THE MONTHLY RED MEAT OUTLOOK: CATTLE & BEEF

MAY 2019

Beef prices advanced in April, with the Choice cutout gaining almost $6 while the Select cutout was about steady with where it began the month. The big story however, was a sharp break in cattle futures that began on April 22 and has continued unabated since then **(Figure 1)**. The June live cattle contract has shed almost $10/cwt since the drop began. Exactly what prompted the sell-off is not clear. Cattle futures had been in an uptrend since last November and perhaps they had just reached unsustainable levels. Large speculators had built a massive long position and when they started to run for the door, the selling got intense. There wasn't much of anything that changed in the fundamental supply/demand picture that would justify such a huge decline, but once the futures started to fall so quickly, it had ramifications in the cash markets. Cattle feeders could no longer demand higher money for cattle and beef buyers became much more cautious as well. Cash cattle prices had been working higher until just before the break and had moved back to the $128/cwt level, but since the break, packers have had success in buying cattle cheaper. Last week, the cash cattle market averaged $123.76 and the market probably has further declines in it's near-term future. Given that cattle cost fell while the beef market held together, packer margins have expanded to around $130/head and could easily reach $200/head before this month is done.

> **Huge feedyard placements** this spring increase the odds of **big beef production** this fall

SUPPLY PICTURE

Fed cattle availability is increasing seasonally here in May and will continue to expand in June. This is a normal seasonal pattern driven by large placements at the end of last year and the beginning of 2019. Packer margins are very healthy and thus packers have a lot of incentive to kill as many cattle as they can get their hands on. Last week's steer and heifer slaughter came in at 532,000 head – about 2.5% greater than volume the same week last year. By the time we get to the end of May, it is reasonable to expect fed kills to be close to 540,000 head per week. So, we are not seeing anything unusual in the number of fed cattle being slaughtered this spring. The non-fed kill, cows and bulls, averaged about 6-7% above last year during April and it looks like that pace could continue through May. The increase in cow slaughter is being driven primarily by an increase in the slaughter of dairy cows as milk producers react to poor profitability that has plagued the dairy industry for months now. That has worked to increase the availability of lean beef trimmings so far in 2019.

Cattle carcass weights have been a concern over the past few months due to an especially tough winter that was detrimental to cattle feeding performance. But recent data suggests that perhaps that problem is beginning to moderate. After spending much of February and March well below last year, carcass weights have been slow to decline in April and are in danger of exceeding last year's level at some point during May. This comes as somewhat of a surprise since most industry observers had expected the effects of the severe winter to keep carcass weights depressed right through May. So, while we had originally thought that beef production in May could be flat with or slightly below last year, the unexpectedly heavy carcass weights offset smaller slaughter numbers and push beef production in May close to last year's level. However, it's not clear that the story on carcass weights is done since there is a possibility of further sizeable declines in the next few weeks as weights make their seasonal bottom and then head higher toward a peak in October.

As the pens have dried out in feedyards this spring, cattle feeders have been aggressively restocking. Feedyard placements during March were reported up almost 5% from last year and we estimate that April placements could be as much as 10 - 15% greater than last year. Cheap corn and relatively cheap feeder cattle prices have been driv-ing the cattle feeder's desire to put more animals on feed. Of course, this bulge in placements will eventually result in big supplies of fed cattle this fall and winter. If cattle feeders continue to place animals at such a rapid pace in the next couple of months, then the market is likely to be sharply lower this fall when those animals become slaughter ready. Buyers need to keep an eye on this and perhaps re-frain from committing to forward contracts for delivery this fall until the extent of the supply picture becomes clearer. It could be a very weak pricing environment.

DEMAND SITUATION

International demand for US beef looks sluggish and seems to be deteriorating with every passing day. USDA reported beef exports down 6% year-over-year in February and the weekly data since then suggests double-digit declines in March and April **(Figure 2)**. All of the major destinations seem to be taking less US product, so it's not something country-specific but rather probably related to economic slowdown in the importing countries along with the high price of US beef in recent months. Of those two factors, the global economic slowdown is more concerning since the price situation in the US will become more favorable for international buyers in relatively short order. How long the global slowdown will last is difficult to know, but it will probably be measured in terms of quarters rather than weeks.

> Beef exports are concerning; a **slowdown** in **the global economy** may be to blame

Domestic demand for beef appears to be good, but not great. **Figure 3** provides the price-quantity scatter diagram for the blended cutout for Q2. The 2019 data point lies just below the long-run average demand curve and that is moderately below the data points for 2017 and 2018. Keep in mind the 2019 data point is a combination of known data from April and forecasted data for May and June. The chart reflects our belief that domestic demand this year in Q2 will be a little softer than in recent years, but not a particularly bad demand environment. The futures are telling us that pork prices are going to be sky-high this summer and it looks like chicken prices will also be above last year. Both of those are supportive to beef demand. The real wild card in the demand picture is whether or not the US economy will soften similar to what is being observed in other parts of the world. We are banking on some moderate macroeconomic weakness, but not a full-blown recession in the second half of 2019.

The recent sharp drop in live cattle futures has reset expectations in the beef markets. All of the remaining 2019 futures are now trading well below the spot market for cattle and that has made buyers much more cautious about extending coverage too far into the future. Based on our fundamental analysis, the June and August futures look appropriately priced, while the more deferred futures contracts still look too high. Beef buyers should take advantage of this depressed near-term pricing environment to lock in the very attractive pricing that the June and August contracts are currently implying but are ad-vised not to extend that coverage into the fall months when we think price levels could actually be lower than what the deferred futures imply today.

SUMMARY

The recent sharp downward movement in the live cattle futures has thrown a wet blanket on the cattle and beef markets. However, beef availability should not be overly burdensome in May and perhaps even June. Export demand for US beef is weak and domestic demand is good but not exceptional. Look for middle meat pricing to remain strong through mid-June but end cuts should trend lower from here. Beyond mid-year, things look a bit gloomier. Supplies will be increasing due to large feedyard placements this spring and demand could come under more pressure as the global and US economies slow. **Table 1** provides our price forecasts for the next six weeks.

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Figure 1: Jun 19 Live Cattle Futures

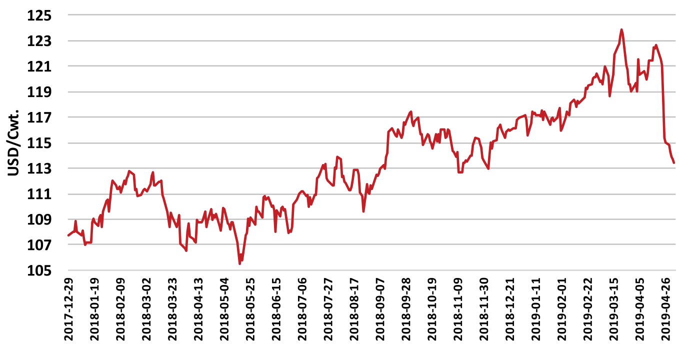

Figure 3: Blended Cutout vs. Per Capita Beef Consumption, Carcass Wt, Q2

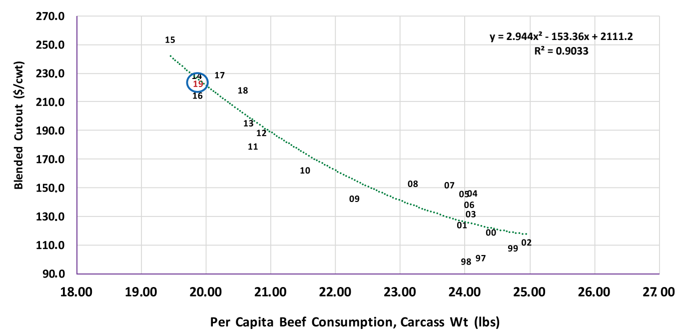

Figure 2: Total Weekly Beef Exports

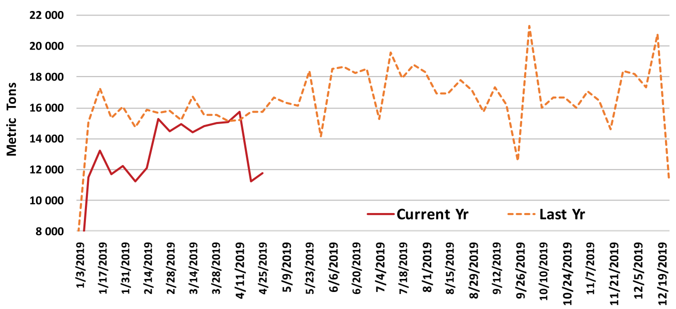

Table 1: JSF Cattle and Beef Price Forecasts

	15-May	22-May	29-May	5-Jun	12-Jun	19-Jun
Choice Cutout	229.5	229.5	226.9	222.9	218.5	214.6
Select Cutout	209.8	208.1	205.9	203.5	203.0	200.6
Choice Rib Primal	399.4	403.3	391.1	380.0	362.2	349.9
Choice Chuck Primal	173.9	172.3	173.0	171.7	169.4	168.9
Choice Round Primal	163.5	161.6	163.0	161.0	160.1	158.4
Choice Loin Primal	342.0	344.9	338.0	330.0	324.6	317.0
Choice Brisket Primal	198.6	195.2	192.7	190.2	188.3	185.5
Cash Cattle	119.4	118.2	115.3	114.2	113.4	112.6

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