VOLUME 2, ISSUE 4

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

THE MONTHLY RED MEAT OUTLOOK: CATTLE & BEEF

APRIL 2019

March saw beef prices continue to work higher, with Choice cutout gaining about $8 while the Select cutout added about $4. That price strength didn't spill over into the cash cattle market however, and prices there hovered in the $127-128 area for most of the month before dropping to $126 near the end of the month. This, of course, allowed packer margins to expand and we estimate that they are currently making about $100/hd. Feedyards in the northern cattle feeding areas are still very muddy, but conditions in the south are much more favorable for good weight gains and so some of the winter weather impact we've talked about in recent months is starting to fade. However, packers in the last couple of weeks have been running slaughter levels above what our models indicate should be available and, if that continues, it has the potential to tighten up available supply in April and May and that could lead to another small advance in the cash cattle market. Of course, it is always possible that USDA has under-estimated the number of cattle on feed and if that is the case then the big kills are justified and packers might be able to get away with bigger-than-expected kills without much increase in the cash cattle market.

> Middle meat prices projected to be **10% over last year** as spring grilling season heats up

SUPPLY PICTURE

Last week's fed cattle slaughter came in at 479,000 head, which seems really large relative to the number of cattle placed on feed 5-6 months ago. Our models suggest that something in the 460-470,000 head range would be more appropriate for late March and most of April. By the time we get to May however, cattle supplies will be increasing and we should see kills advance toward 515,000 head per week or perhaps a little more. Carcass weights are still down relative to last year with the most recent USDA data showing steer weights about 11 pounds under where they were last year at this time **(Figure 1)**. That equates to about 1.3% below last year and will subtract from beef production in the near-term. Since the fed kill is running almost dead even with last year, the lighter carcass weights mean that fed beef production is currently 1-2% below last year. If packers pull back on the kill in the first weeks of April to a level more consistent with what prior placements indicate, then we could see year-over-year beef production down 3% or more. That should provide support to the beef market, but probably does more harm than good for the cash cattle market.

USDA recently reported that feedyard placements during February were up 2% from the year prior and that was a bit of a surprise since most analysts were expecting a 4-5% decline. This may be the first in a long stretch of year-over-year gains in feedyard placements and that will create relatively abundant cattle supplies in the second half of the year. Feeder cattle got very cheap during February and apparently it was hard for cattle feeders to resist placing large numbers in their yards, even though they were not that great due to muddy conditions. The deferred live cattle futures (i.e., from August onward) have risen to a pretty high level and that allowed cattle feeders to place cattle at a profitable margin by hedging the output with futures. Part of the reason that deferred live cattle futures have been so strong is due to a huge rally in the hog futures during the latter part of March. Traders in that market became increasingly bullish on the prospects for the US to ship large quantities of pork to China as that country struggles with an outbreak of African Swine Fever (ASF). As a result, deferred lean hog futures soared and some of that spilled over into the deferred live cattle futures. We think the market has over-reacted to the ASF situation and, as a result, deferred live cattle futures are way too high. As an example, our models suggest that fair value for December 2019 cattle is below $110, but the futures are currently pricing them closer to $120. The whole ASF situation will take some time to play out and it's hard to tell exactly what the impact will be on the cattle and beef markets, but it certainly has afforded an opportunity for cattle feeders to ramp up feedyard placements this spring and hedge them profitably with futures.

DEMAND SITUATION

Consumer confidence in the US remains quite strong, even as the rest of the world is experiencing an economic slowdown. As a result, domestic beef demand has remained very good. We think it is only a matter of time before the US economy also starts to slow. For now the US consumer seems to be in good shape and is an eager purchaser of beef at both retail and foodservice outlets. During the last few weeks, beef's competitive position has benefited from a sharp increase in pork prices as pork buyers

THE MONTHLY RED MEAT OUTLOOK: CATTLE & BEEF

APRIL 2019

scrambled to make purchases when hog futures rallied sharply on ASF fears. Prior to this latest run-up in pork prices, beef was quite expensive relative to pork. **Figure 2** compares the blended beef cutout to the pork cutout and it's clear that the gap between the two has narrowed substantially in recent weeks. Furthermore, spring has arrived and that almost always brings about a strong seasonal increase in beef demand as consumers are eager to fire up their outdoor grills. All of this points to continued strong domestic beef demand in April, with the middle meats garnering most of the attention. Our models suggest rib prices could run 9-10% higher than last year in April and May. End meats, outside of briskets, should see demand wane and that will likely offset some of the gains in the middles and so we look for only modest strength in the cutout going forward **(Table 1)**.

Figure 1: FI Steer Carcass Wt.

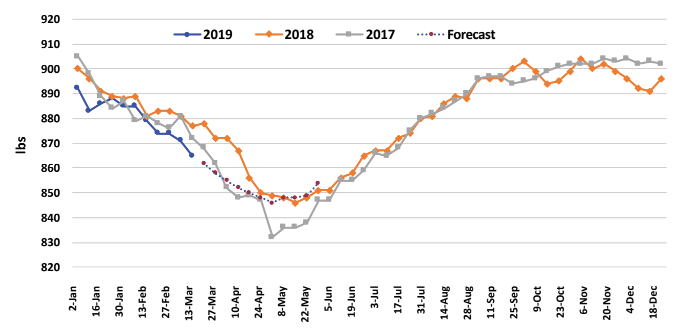

Figure 2: Blended Beef Cutout Minus Pork Cutout

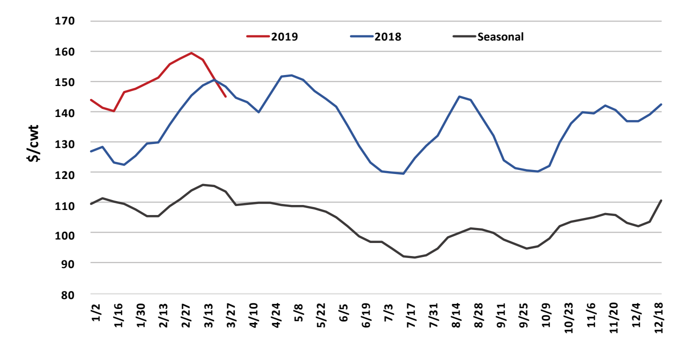

Table 1: JSF Cattle and Beef Price Forecasts

	10-Apr	17-Apr	24-Apr	1-May	8-May	15-May
Choice Cutout	227.3	228.6	229.9	231.1	232.3	234.6
Select Cutout	217.2	217.8	218.3	216.4	214.2	212.1
Choice Rib Primal	389.8	395.4	402.0	404.0	409.0	416.0
Choice Chuck Primal	176.5	176.1	175.3	174.2	173.4	173.9
Choice Round Primal	179.5	177.0	175.3	173.3	172.1	170.4
Choice Loin Primal	315.8	321.8	326.5	333.6	338.0	345.6
Choice Brisket Primal	190.8	192.1	193.7	194.4	193.9	195.6
Cash Cattle	127.8	128.5	127.9	126.9	125.4	126.6

Export demand for US beef does not look quite so rosy. The weekly USDA data suggests that beef exports in Q1 were down about 14% from last year. This is not a good trend and we think is reflective of struggling economies in the importing nations along with high beef prices here in the US. The US typically exports about 10% of the beef it produces, so it is not overly dependent upon export markets, but they do have an impact. However, sometimes the weekly data doesn't match up well with the official USDA monthly numbers, but those are reported with a two-month delay so we won't actually know how serious the export situation was in Q1 until late May. Still, this is something that needs to be watched and our sense is that global macroeconomic conditions in the second half of 2019 will be worse than in the first half – that likely means that US beef exports will continue to underperform for most of the year.

> Beef exports are **not keeping pace** with last year

SUMMARY

Cattle slaughter has been running above expectations recently and may be an indication that there are more cattle available than what the prior placement data indicated. On its own, that would be bearish for cattle and beef prices, but carcass weights are also down substantially due to the severe winter and that could easily keep beef production below last year for the next month or two. Strong incentives exist for cattle feeders to restock their feedyards and they seem to be moving in that direction. That portends greater beef availability in the second half of the year. Domestic beef demand remains on good footing, but there are concerns about international demand. Buyers needing middle meats and grinds for spring should move fast to cover at least a portion of their needs, while those in the market for end meats would do well to delay purchases as long as possible. The ASF situation in China will impact both beef and poultry prices in addition to pork, so buyers need to monitor that closely. It hasn't happened yet, but if huge amounts of pork get shipped to China then it's a good bet that beef prices will exceed expectations.

DR. ROB MURPHY BS, MS, PhD Agri Economics,
Executive Vice President, Research & Analysis,
J.S. Ferraro & Company

E: Rob.Murphy@jsferraro.com

Dr. Rob Murphy is an agricultural economist and business leader with over 28 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.