



WEEK ENDING MAY 21, 2021

# THE PORK WRAP

Pork packers have done a superb job of reclaiming their margin after it almost went to zero three weeks ago. They figured out that all they needed to do was to cut the Saturday kill down to almost nothing and suddenly their margin began to improve. This week it stands at \$11/head, which is outstanding for this point in the year. The kill reduction has helped the cutout move higher (up \$3.67 on a weekly average basis) and the cash hog market move lower (WCB down \$4.33 on a weekly average basis). Both the cutout and the negotiated cash hog market figure into the LHI calculation and I estimate that the LHI is currently about 2/3rd negotiated hogs and 1/3rd cutout. That means the LHI is going to have a hard time advancing further as long as the negotiated market is on the defensive.

The cutout made a big jump today and that ignited a futures rally that saw the Jun contract exceed \$114.50, more than \$3 over today's LHI. Now it is possible that the negotiated market could turn higher, but the way it has moved steadily lower tells me that we have already passed the tightest hog numbers. Further, if the cutout stalls or turns lower, there will be very little hope of turning the negotiated hog market higher because packers will be back in margin management mode. I guess a good question at this point is, "What are the odds of the cutout stalling or turning lower?" Given that the cutout has only declined one week since December, the odds don't look very good, but all of the last-minute Memorial Day business is complete now, so there could be a little let-up in demand next week.

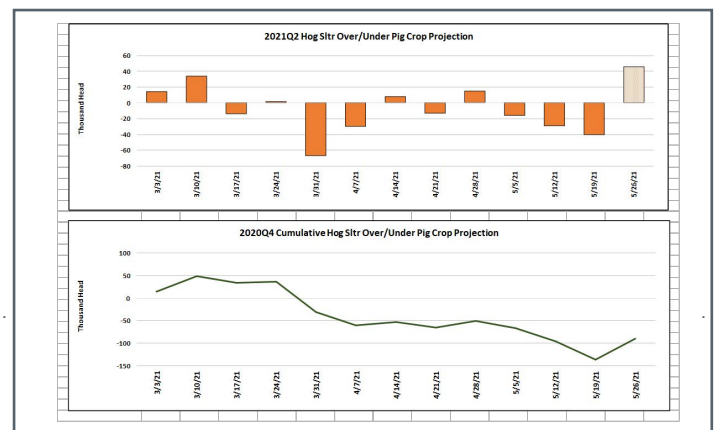
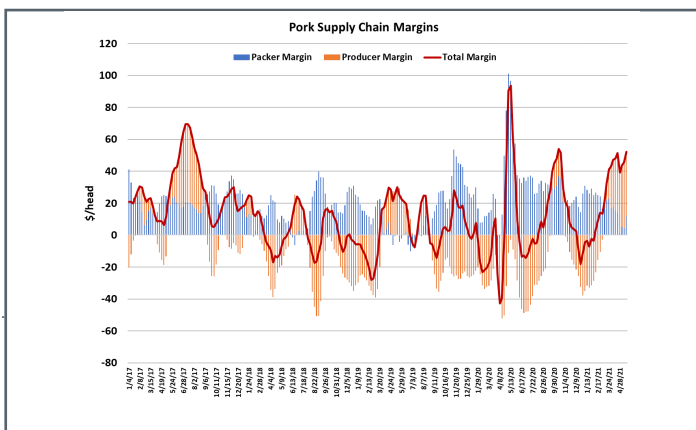
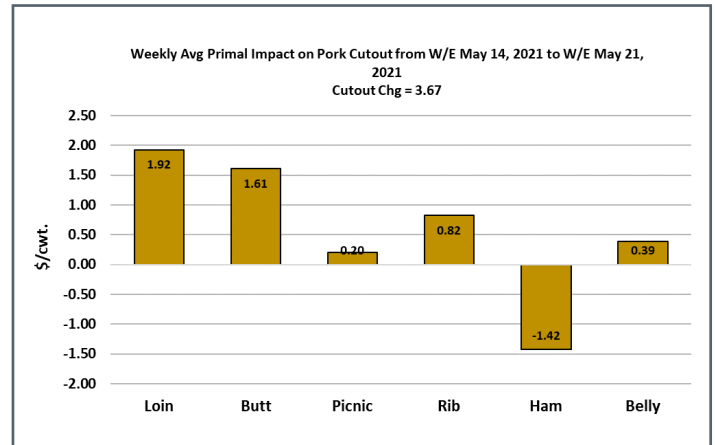
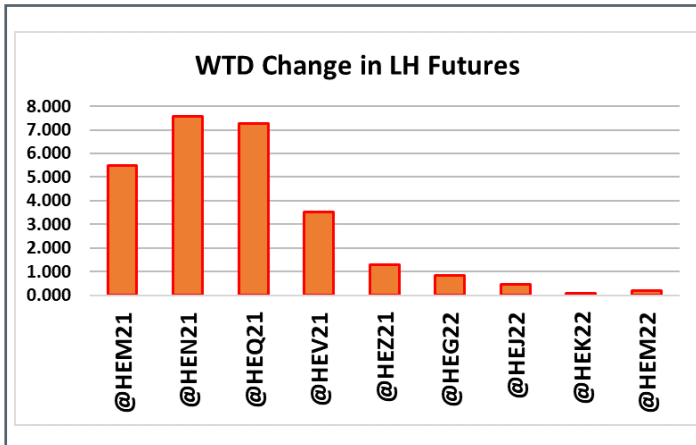
All of the primals were higher this week except hams, and those made a fairly strong recovery on Friday. The logical place for price weakness to develop would be in the retail cuts—loins, butts, ribs as demand at retail scales back post-Memorial Day. But there is really no guarantee that demand at retail fades after the holiday. This is a very unusual demand situation that we are in and it feels more like demand is permanently moving to a new, higher level than simply cycling up and down every couple of months. Retailers are not balking at paying a \$120 cutout because their customers are not balking at paying whatever price they slap on pork in the meatcase. Still, from an analyst's perspective, it is a lot easier to forecast a declining cutout from these super-high levels than it is to forecast it continuing higher.

I'm looking for a modest decline in the cutout during June, but have it holding above \$109 until the end of the month. The combined margin gave a hard head fake about three weeks back and is now continuing higher. It has double-topped like that before and when it did, it signaled some softening shortly thereafter. I've included the price-quantity scatter diagram below for the month of May and you can see how incredibly strong demand has been this year.

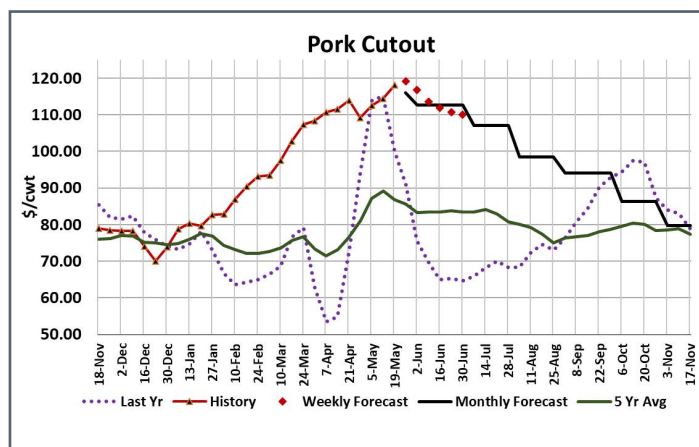
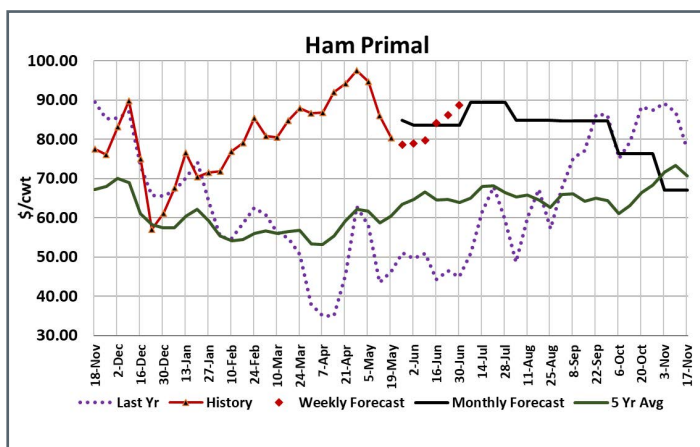
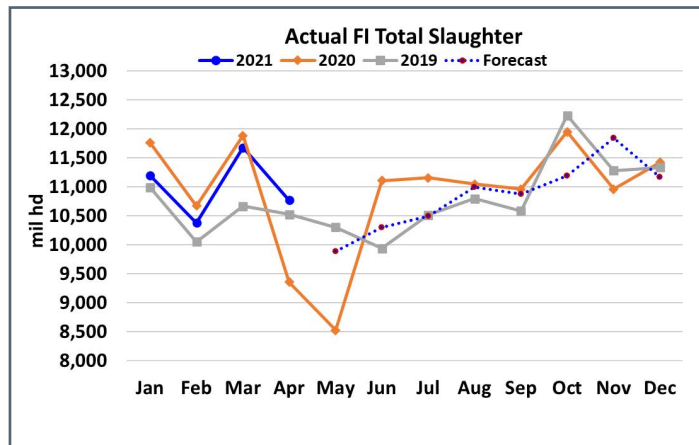
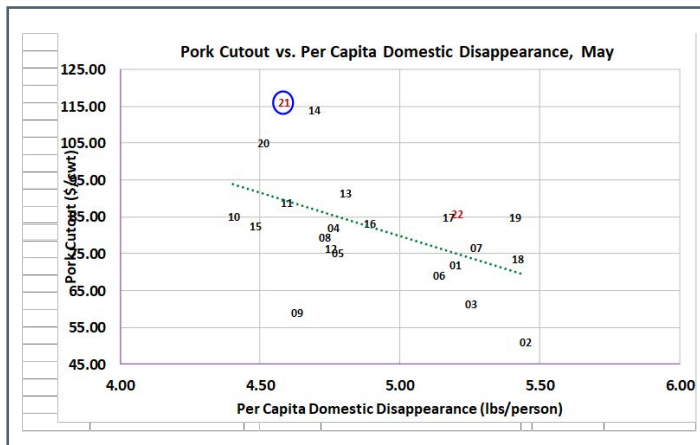
Pork demand is also being supported by really high beef and chicken prices. It seems to me that when one of that trio starts to soften substantially, the other two will follow. Since pork is the one that got this demand party started back in the winter, it is a good candidate to turn lower first. Today's big increase aside, I'm not sure I'm ready to look for the hams to appreciate much in the near-term and the bellies are not acting like they will make a big move higher either. Together, those two primals represent about 41% of the carcass, so it may be hard to get much more cutout appreciation without help from those processing items.

This week's slaughter came in at 2.39 million head, about flat with the week before. It's hard to compare against last year, but slaughter for this week in 2019 was actually a little smaller than what was posted this week. Weights are almost identical to where there were at this point back in 2019. So, there is not much that is abnormal about the supply picture at this point. Kills usually reach their annual lows around the end of June, so we have about five more weeks where slaughter levels should be declining. Based on the prior pig crop, I'm forecasting the slaughter low point to be about 2.33 million head. That is only 60k lower than this week's slaughter. So the end of shrinking hog supplies is within sight. The labor problems that are plaguing the beef industry are also present in the pork industry, but they are having less of an impact in pork due to where we are in the seasonal supply cycle. That will change in the fall when hog numbers swell to the annual peak and it will be interesting to see if pork packer margins blow out to incredibly high levels, the way beef margins have, when the supply of animals swells late in the year. My guess is that they will.

Hog producers had better hope that pork packers get their labor issues sorted out before Q4 gets here. The recent pullback in the corn market has given hog producers a little relief, but the futures are still projecting breakevens this fall in the mid-\$80s. That is about where the Dec contract finished this week. Next week, watch for some softening in the retail primals and possibly the cutout. It could be a down week if the cutout loses ground next week. Stratospheric markets like the one we are in now need to be constantly fed bullish news in order to keep climbing.



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