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WEEK ENDING JULY 23, 2021

THE PORK WRAP

The negotiated hog markets were lower this week, with the NDD market dropping over $3 and the WCB off a little more than $5. The cutout, meanwhile, added about $2.50 on a weekly average basis. That helped move packer margins back up to $15/head and it is beginning to feel like packers are in control again after that disastrous drop in the cutout and margins back in June. This week was all about the bellies, which have now moved to an all-time high.

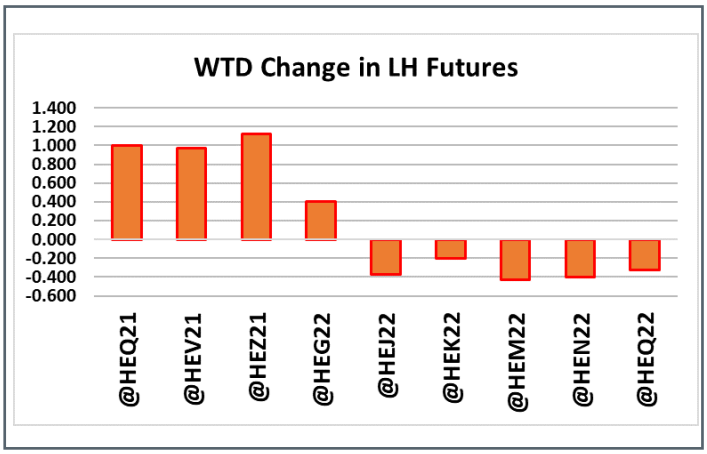
Without the strength in the bellies, it is a good bet that the cutout would have been lower on the week. Bellies can be a fickle beast and very volatile. Recall that it was a sharp drop in belly prices back in June that precipitated the big decline in the cutout. At that time, the belly primal went from around $200 to $150 in just 2 weeks. That type of downdraft could happen again at any moment given how high belly prices are. I suspect that bellies are caught up in a demand surge for products containing fat. Pork 42s also made an all-time high this week. There is no telling how long that demand boost will last, but with high corn prices it is a pretty good bet that livestock producers are not going to feed animals any longer than they have to and that will tend to limit the amount of animal fat that gets produced. Other parts of the carcass are struggling. The butts took a huge price hit this week and the loins look to me like they may be next. In order to turn the cutout lower we need to see increased pork production.

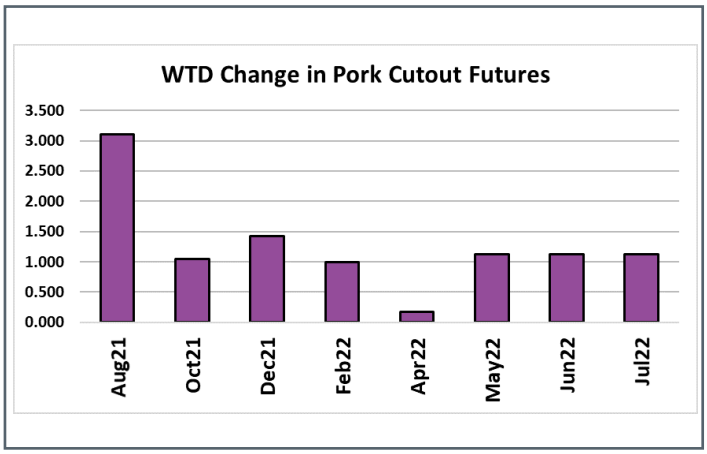
We are at that point in the calendar when kills begin to expand seasonally and it looks to me like this week's kill will be considerably larger than last week–perhaps around 2.36 million head. That is pretty close to what the pig crop implied (chart below). By Labor Day, I expect to see kills north of 2.55 million head. If that doesn't turn the cutout lower then it will be time to buy everything in the complex with both hands because something very unusual is going on. Hog weights are currently approaching their annual lows and this week's data confirmed that they haven't started to rise yet. That will come in August. The DTDS weights are at all-time lows, which tells me that hog producers must be very current. It is a mystery why the negotiated market has been printing lower in recent days if hogs are so light and current.

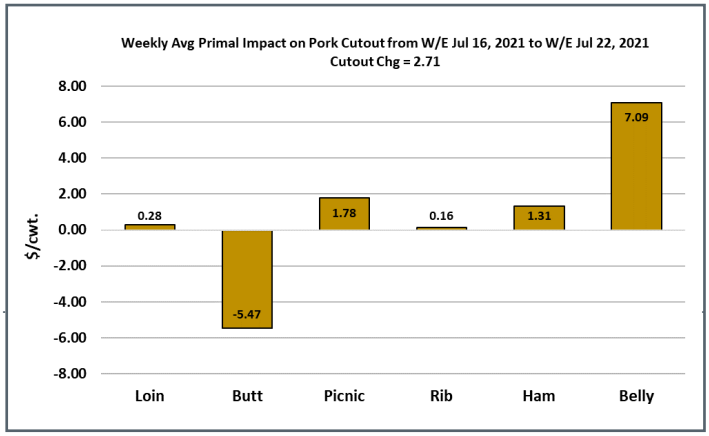
Now that packers have a decent margin once again, perhaps they will focus on increasing the kill and that might stabilize the negotiated hog market. Right now, the LHI seems to be stuck around $112 as higher cutout values are being offset by lower negotiated hog prices. My forecast has the LHI beginning to move lower in the next couple of weeks, that means that Aug is likely to expire well above where traders thought just a few weeks back when it ventured into the high $90s. I guess we shouldn't be surprised by that since traders at one point were pricing the Jul contract at $100 and it ended up expiring at $112.

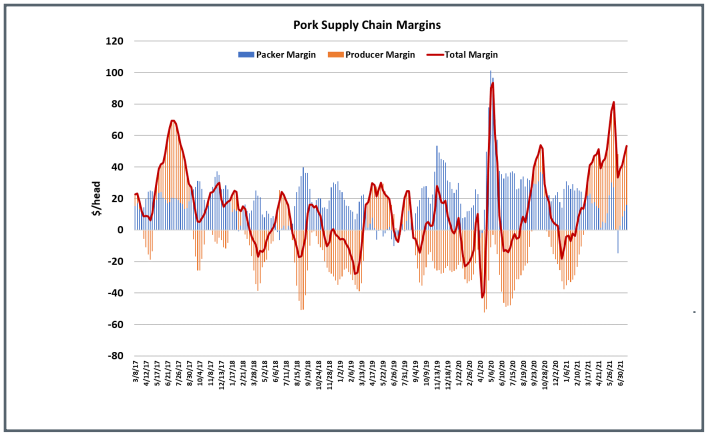
I see the price declines accelerating between the Aug and Oct expirations. The cutout futures are valuing the cutout at $103 in October and that just looks way too high for me. Kills will be much larger then and the hogs will be heavier. I favor a cutout in the low $90s for October. If I'm right about that then the LHI might trade in the low $80s since with expanding supplies we would expect packer margins to be relatively wide in October. One sharp belly pullback like we saw in June would quickly correct that problem. The export data released Thursday morning wasn't very encouraging. Net new sales to China were negative, meaning there were more cancellations than new sales. Movement was pretty good to Mexico and Japan, but if China is withdrawing from the US market then I'm afraid it will leave a hole that is too big for other destinations to fill.

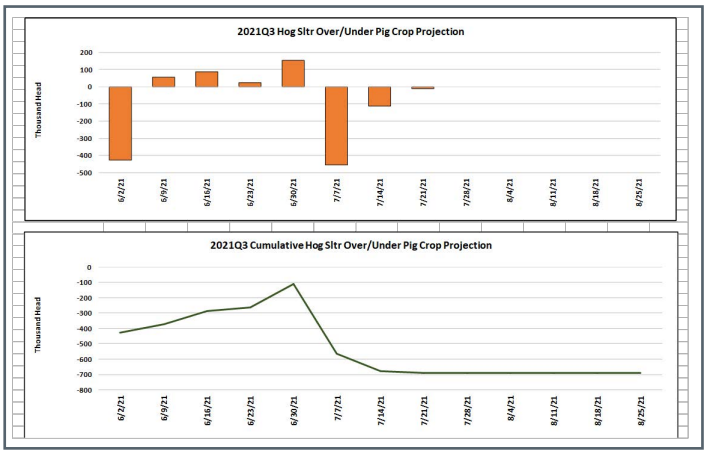
It seems that recently the futures have spent the early part of the week pumping up the deferred contracts in response to the rising cutout but then when Thursday arrives the export data throws a wet blanket on the party. Next week, watch the bellies and hams. They are the main drivers of the cutout at this point. Any stumble in either one of those has the potential to greatly alter the psychology of this market.

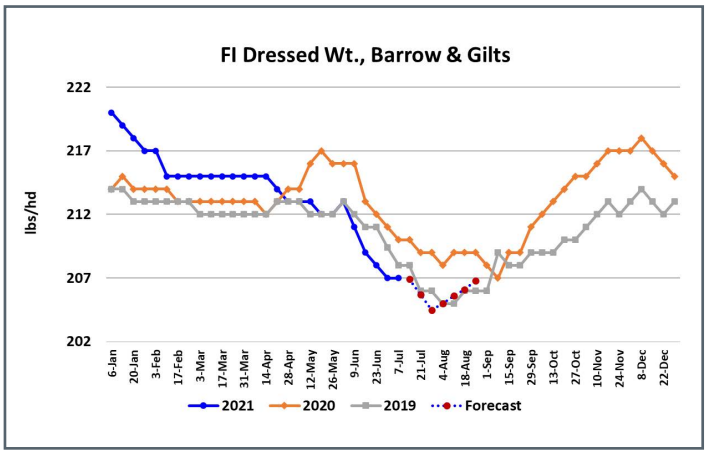


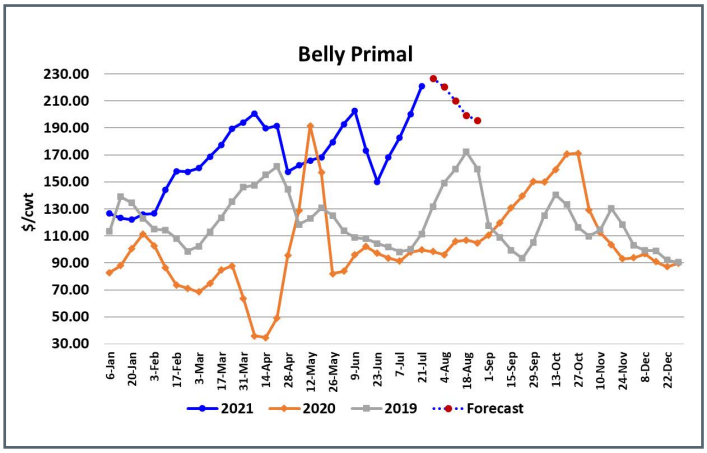


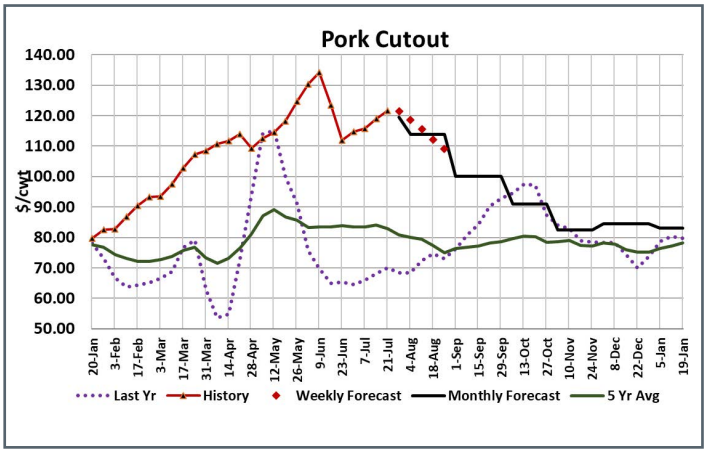












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Dr. Rob Murphy is an agricultural economist and business leader with over 29 years in the industry. He has a wealth of experience in the North American meat and livestock industries studying, analyzing and predicting market movements.