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WEEK ENDING JULY 30, 2021

THE PORK WRAP

The pork cutout added a little over $2 this week, but the cash hog markets remained on the defensive. The WCB negotiated market declined about $3 on a weekly average basis. With the negotiated market moving lower and the cutout moving higher, the LHI stayed essentially flat on the week. In fact, the LHI is at nearly the same level it was when the July contract expired over two weeks ago ($112). That didn't stop the futures from selling off this week, with the Oct contract losing over $4.50.

Traders are likely becoming more pessimistic about the export prospects for this fall since the recent weekly export data hasn't looked all that good. In addition, there may be concern that hog supplies this fall will test packing capacity, which has been limited by labor shortages. But while the futures market was becoming more bearish, I was becoming more bullish. I was forced into a major forecast revision this week because the strength in the cutout has not abated as quickly as I anticipated. Trim markets are on fire and sow prices are heading higher rapidly. I pushed the price forecast for nearly all of the primals higher over the next several months. That, in combination with the futures selloff, helped to remove a lot of the mis-pricing from the fall and winter contracts. I'm also now showing Aug as under-priced given that the index hasn't moved in two weeks and the contract only has 10 more trading days until expiration.

At today's close, the Aug contract is nearly $6 under the LHI and that gap seems excessively wide for a market where the index hasn't shown much movement. Pork demand seems to be back on the rise, as indicated by the combined margin chart below. I thought that perhaps the combined margin was giving us a head fake by moving higher a few weeks back, but now it is hard to deny that an uptrend is back in place. At the same time, hog supplies have been slow to expand after reaching a bottom around Independence Day. This week's kill was estimated at 2.33 million head, essentially unchanged from the week before. That was less than the pig crop projected and the chart below shows that with four weeks to go in the quarter, the cumulative under-kill of the pig crop has amounted to around 800k head. If these under-kills continue, we will likely experience a total shortfall of about 1.1 million head for the quarter. You would think that with actual hog supplies tighter than expected during the summer, that hog prices would be rising and packer margins would be tight. Instead, the opposite is true.

Packer margins this week came in at close to $21/head, a $5 increase from last week and a really hefty margin for this time of year. Packers are simply not interested in pressing the kill higher and that probably has something to do with the tight labor situation. So, it is like they are in margin management mode without having any actual margin problem. So far, the carcass weight data isn't indicating any significant back up of hogs in the system and in fact the DTDS weights are near all-time lows.

I expect that packers won't let the margin get much bigger without sharing some of it with producers and so if the cutout continues to strengthen, I think it increases the chances that negotiated hog markets stop declining. I'm not looking for a lot more strength in the cutout from current levels, but I could be wrong about that. The belly primal made another all-time high this week and 42s averaged an astounding $131. The small kill this week could support the cutout again next week. Looking further out, it does worry me that USDA seems to have missed the current pig crop so badly and raises the possibility that they also underestimated the Mar/May pig crop, which we will begin killing in September. The government told us that the Mar/May pig crop was down 3.1%, so if they were too high on that we might be looking at something closer to a 5% YOY decline in hog availability this fall. If that is the case then we won't likely see the type of price decline that normally happens in the fall.

I'm still rating the Oct and Dec contracts as too high, but that is probably not the case if it turns out the Mar/May pig crop was underestimated. On the demand side, if the current COVID wave intensifies in the fall, it will likely cause a resurgence in stay-at-home behaviors and we already know from experience that is strongly positive for red meat demand. So the perfect storm this fall would be for COVID to surge and the pig crop to be smaller than expected. Next week, watch the negotiated hog markets for signs that they are slowing their descent or even bottoming.

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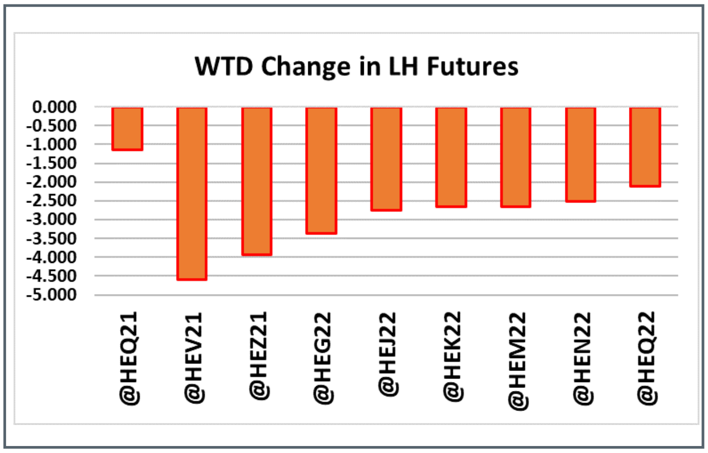

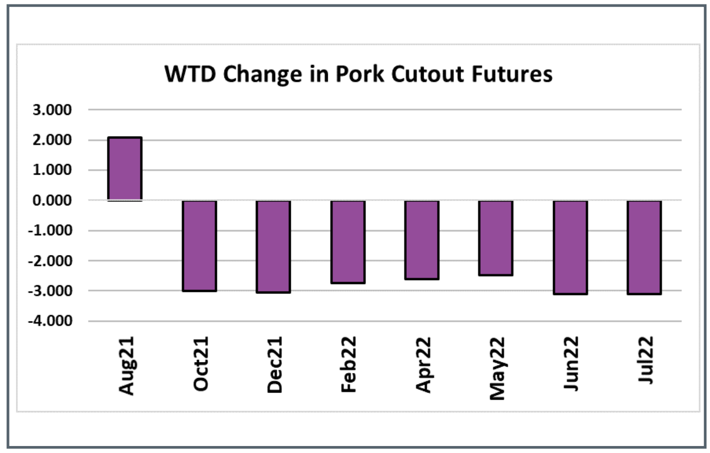

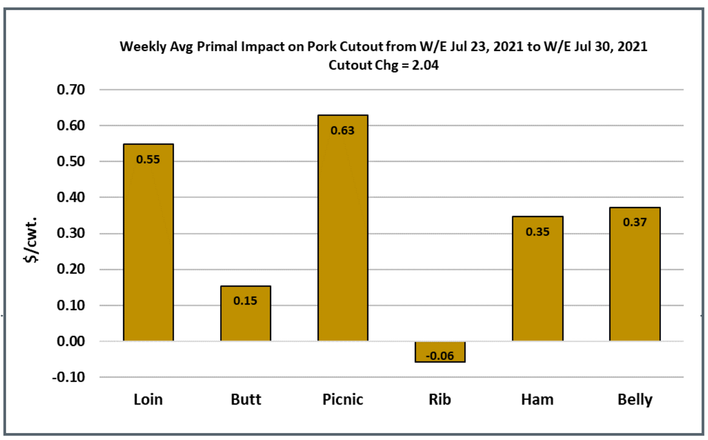

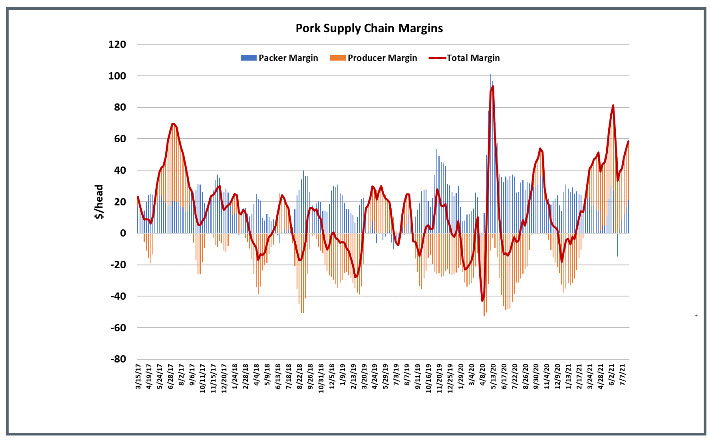

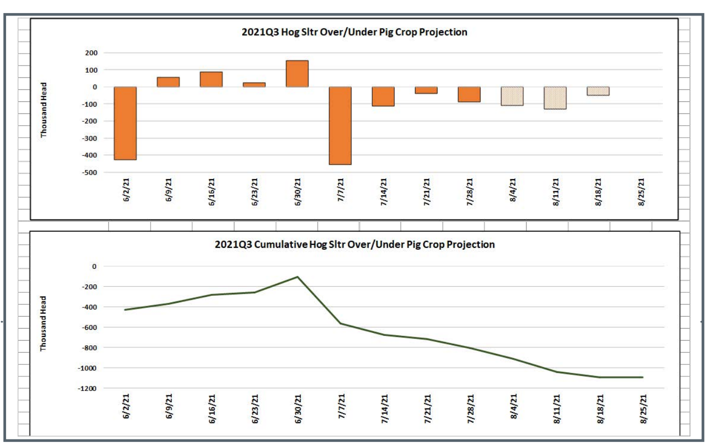

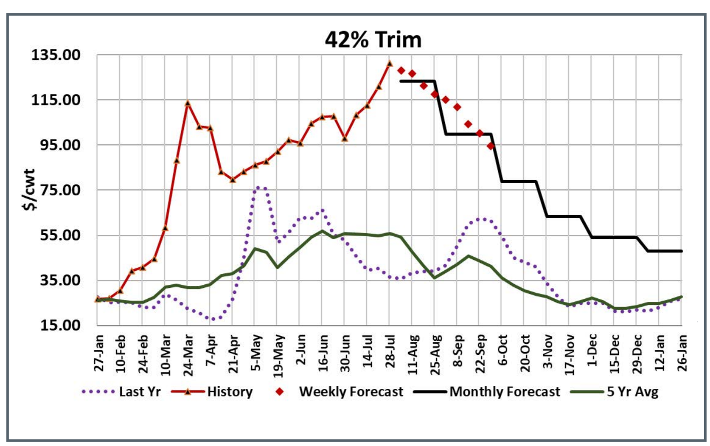

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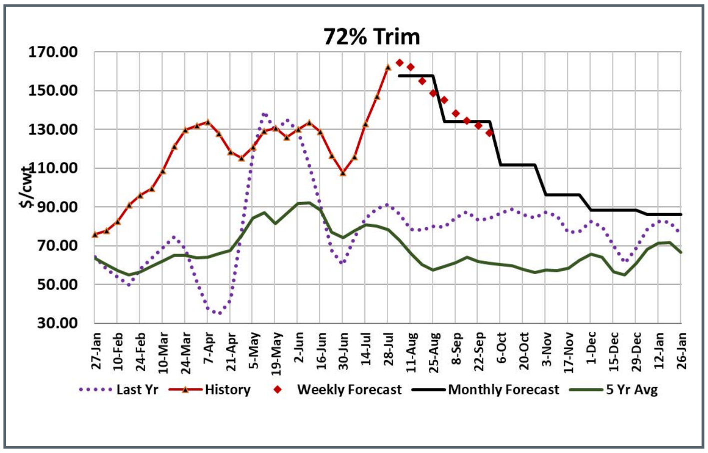

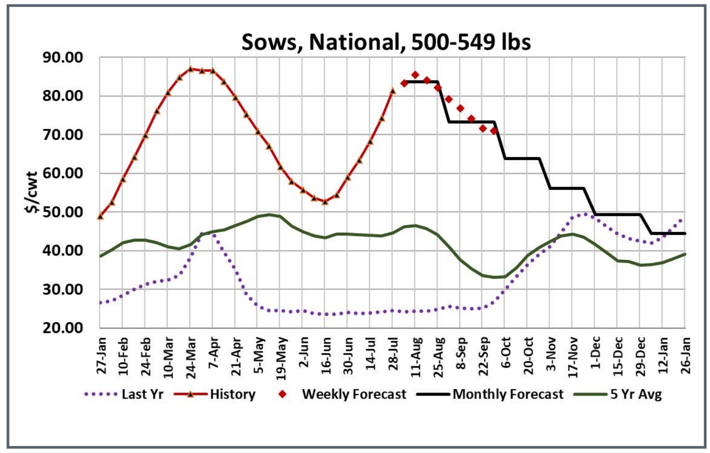

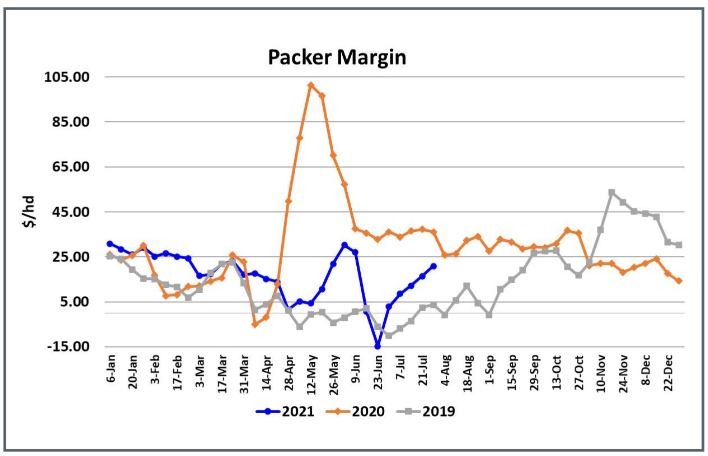

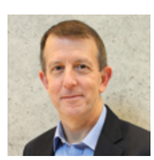

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