J.S. FERRARO

jsferraro.com | 416.306.8788
130 Adelaide Street West, Suite 810 Toronto, Ontario M5H 3P5

WEEK ENDING NOVEMBER 26, 2021

THE PORK WRAP

The hog and pork complex has remained on a downward trajectory in recent days. The pork cutout has lost almost $10 over the past seven trading days and the NDD cash hog market is down $2.60 over the same period. Futures traders have remained optimistic that a turnaround is coming as the nearby Dec LH contract dropped less than $2 and the pork cutout futures were down only $4 over the period. Packer margins are shrinking as the losses in the cutout outpace the decline in cash hogs. Packer margins averaged about $26/head last week and will likely remain close to that this week. Those margins will be about $10 per head less than where they were in early October, when kills were smaller than they are today.

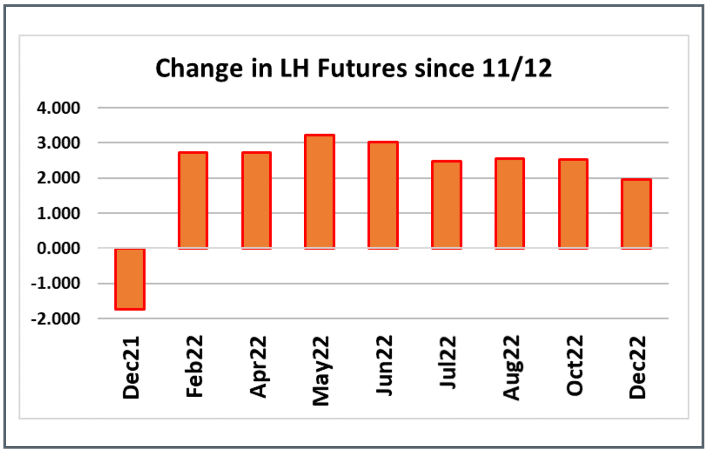
That suggests some modest tightening in the hog supply has occurred, but pork buyers care very little about that. Instead, buyers are reacting to softer demand from their customers and that is helping push pork prices lower as we approach Thanksgiving. The softness in the cutout over the past week and a half has been driven by softer belly, loin and picnic pricing. Hams have held steady, but are beginning to look like they might also soften in the days ahead. Without Chinese buyers scooping up US pork with both hands like they have done in the past two Novembers, price levels have sagged. It is clearly more of a demand-side problem than anything on the supply side because kills are running well below last year's level. Last week's kill clocked in at 2.63 million head and that may very well be the largest kill weekly kill of Q4. My estimate for this week's kill is right at 2.28 million head. Packers are planning on a huge Saturday kill to help offset some of what will be lost on Thursday. The smaller kill could support pork prices next week, but it is not a sure thing. For one, bellies need to gain some traction in order for the cutout to reverse its current downtrend, but this is the time of year when belly demand for processing is generally light. In the old days, November was prime time for users to move bellies into the freezer as a hedge against high prices next spring.

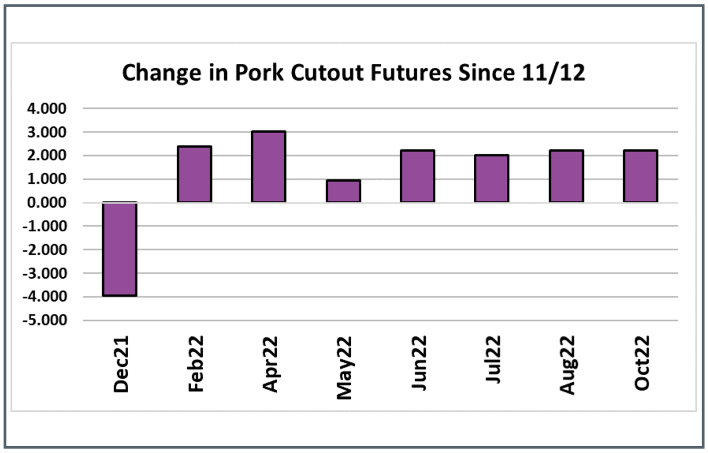
In the last few years, there has been less of that "storage buying" in the fall. As a result, I think there is a good chance that the belly primal continues lower for another couple of weeks and may test the $100 level before it starts to move higher. At the same time it also looks like the hams have topped and are starting to work slowly lower. One reason is that boneless ham premiums to the bone-in have declined recently, but the bigger effect is likely a softening of demand for processing now that December is right around the corner. I find it hard to forecast the cutout higher with bellies steady-weak and hams softening in the next couple of weeks. Trim has also declined a lot lately and there is little reason to call that higher in the near-term. I think the retail items can hold close to current levels though and that means that the downside risk in the cutout might be limited to the $80 mark–only about $5 below where it printed this afternoon.

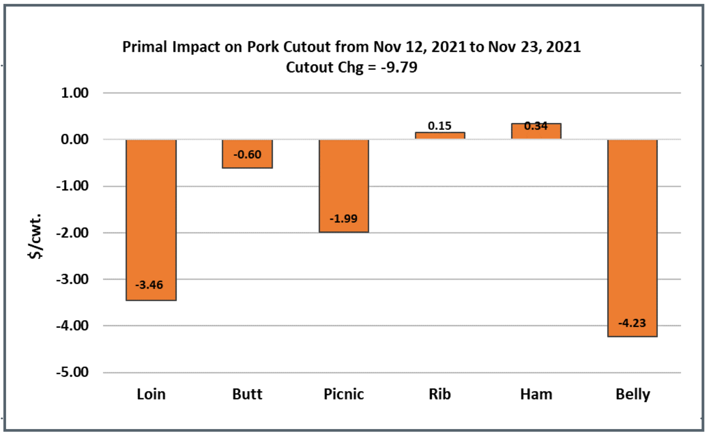
I don't rule out a brief trip back up to $90 next week as the short kill works through the system, but in general my forecast is for the cutout to remain in the low to mid-$80s until Christmas. The risk to that forecast probably lies to the downside. The cash hog market is a little more difficult for me to read at the moment. It does appear to be stabilizing in the mid $50s, but we've seen that happen before only to be followed by further downward movement. Packers are probably not too happy with their margins at present and would like to them closer to $40/head as they have been in the past near the end of the year. They may not explicitly cut the kill, but they probably will take advantage of the time around holidays to give their workforce a much needed break and thus help prevent snugger hog supplies from impacting margins too much in the weeks ahead.

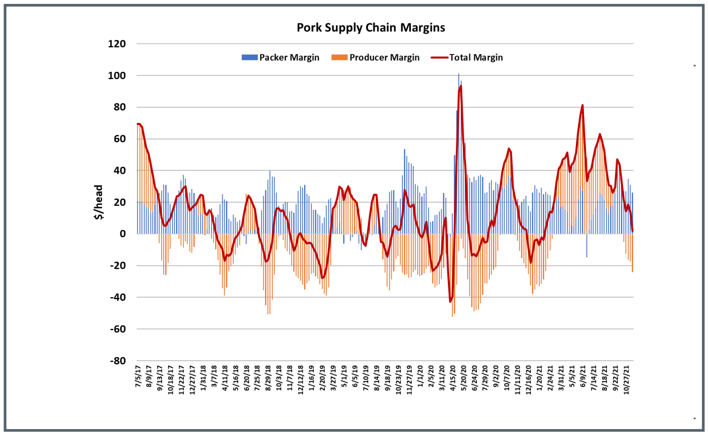
Everyone is aware that USDA called the summer pig crop down 6% YOY and that pig crop will start coming to slaughter next week. Over the past four weeks swine kills have averaged 3.2% below last year, so clearly we are not to the point where hog supplies are down 6% yet. But it seems as though futures traders are expecting that shoe to drop soon. They have been reluctant to press the Dec contract below $74 and have priced in nearly a $10 increase between Dec and Feb expirations. Someone is betting on this market turning higher soon. Time will tell, but I tend to go with what the immediate data is telling me and that suggests that there are sufficient hogs available to prevent a quick run-up in the cash market. Besides, the demand side of the pork market seems to be slowly softening and thus we could get a moderate tightening in hog supplies without much in the way of pork price increases. The combined margin chart below clearly points to a demand downcycle in progress and it is interesting that the combined margin is now approaching zero, which is a level it hasn't come close to in almost a year. Last year at this time the combined margin was in a similar position and it continued lower, bottoming around -$18 near Christmas.

Is something similar in store this year? If it is, that suggests that the cutout will move below $80 and could test $75. That is more pessimistic than my current forecast, but I don't rule it out. Without China picking up as much of the slack this year, any loss of domestic demand will have a bigger impact on the cutout than it did last holiday season. This week's kill won't tell us much due to the holiday, but watch the following week's slaughter closely. If it falls back close to 2.55 million head, then that is consistent with a 6% smaller Jun/Aug pig crop and maybe USDA's survey is correct. However, if it remains in the 2.6-2.65 million head range, then possibility that the pig crop is larger than the survey indicated must be considered.









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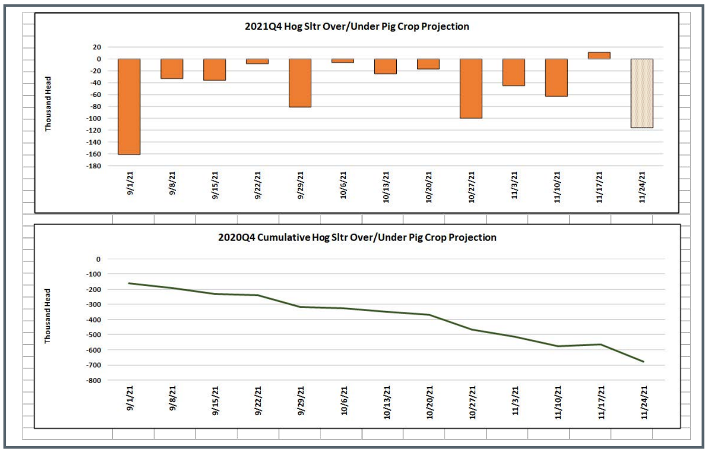

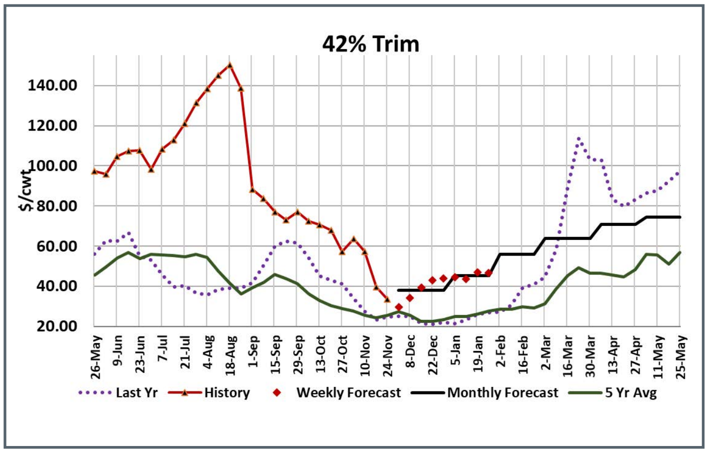

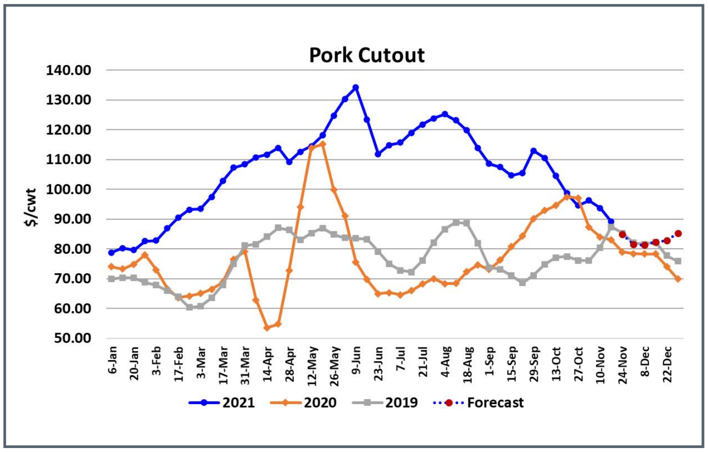

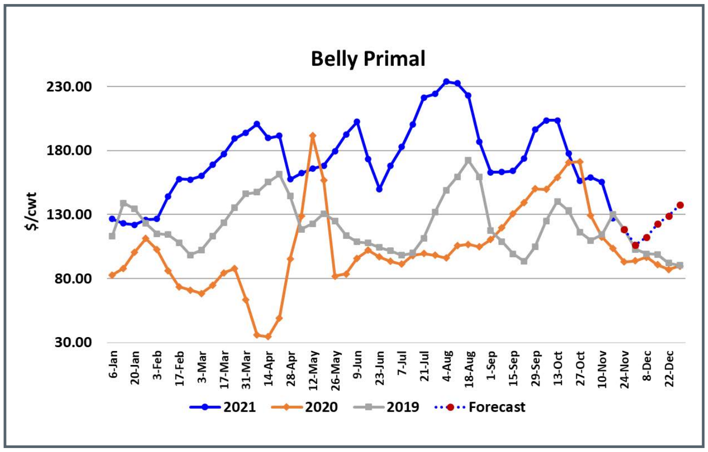

DR. ROB MURPHY BS, MS, PhD Agri Economics,
Executive Vice President, Research & Analysis,
J.S. Ferraro

E: Rob.Murphy@jsferraro.com

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.