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WEEK ENDING FEBRUARY 18, 2022

THE BEEF WRAP

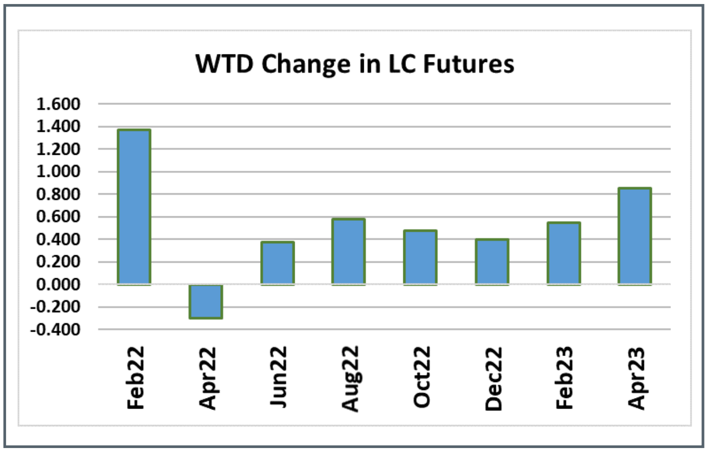
It was another week where cash cattle prices moved up and cutout values moved lower. Packers came out bidding $142 rather early in the week and they managed to get the showlists bought for an average price of $142.25, which is a little less than $2 over last week's average. The Choice cutout dropped $6.43 on a weekly average basis and the Select cutout was down $5.52. That further compressed packer margins, which are now estimated at $360/head. Just three weeks ago, those margins were at $575/head. February normally sees some of the tightest packing margins of the year due to soft consumer demand and seasonally small fed cattle supplies. Prior to 2019, packers would routinely lose about $50-100/head during February, but since then, February margins have been solidly positive. It is pretty clear that overall beef demand is in a downcycle and the combined margin chart confirms this.

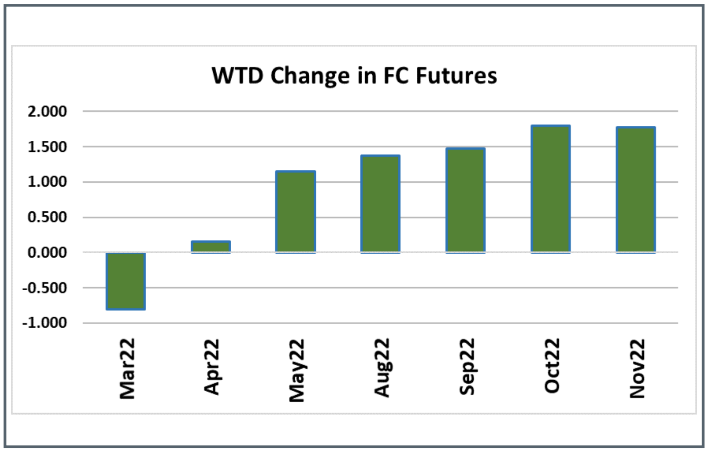
The most important question is when will this downcycle stop? Looking at the combined margin chart, we see that it is approaching the area where it bottomed in the last cycle and it could bottom there this time too, but if demand really is on its way back to "normal" now that COVID has receded, then it would seem like the bottom might be a lot lower than where it is now. My current theory is that consumers are moving beyond the pandemic and getting back to their normal routines. That means cooking food at home is less of a focus than it was during the pandemic and super-high beef prices in the grocery store just make it even easier to pass up. I think consumers are in the process of trading down from beef to pork and that is why we have the beef cutouts falling like a rock, but the pork cutout moving higher. One item that I have been watching closely as a "return to normal" indicator is briskets. During the pandemic, there was a surge in demand for smoking grills as consumers sought to entertain themselves at home. And of course, briskets are a common choice for smokers. The attached chart shows the value of the brisket primal from 2018 to present. Prior to the spring of 2021, the brisket primal had stayed mostly between $150-200/cwt.

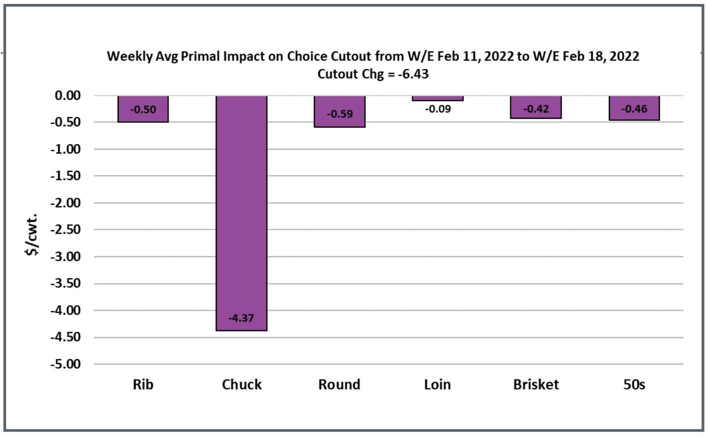
Brisket demand really started heating up in March last year and we have seen a lot of prices in the $250-300 range over the past nine months. Now, brisket prices are falling fast. There have been a couple of other downdrafts in the brisket price that eventually reversed, so I don't want to be too quick to say that this is going to be the one that bottoms back in the pre-pandemic range. And, this downdraft could just be a normal February lull in demand. After all, it is pretty cold outside to be running a smoker. But it was pretty cold in December too when the brisket primal approached $300/cwt. It is still early, but we should keep an eye on the brisket as a leading indicator that beef demand is heading back to pre-pandemic levels. It seems that many market participants are expecting the Choice cutout to bottom soon and my forecast is among them, but there is a very real risk that the cutout continues to slide right on past $260 on its way to a bottom at a much lower level. That would likely shock the market and would almost certainly quash the bullish enthusiasm that has been present in the futures for months now. Remember, in the years just prior to the pandemic the Choice cutout averaged around $220 in March. It probably wouldn't get that low now because there has been a lot of cost inflation since the 2017-2019 years, but $240 wouldn't be out of the question. I definitely think that the risk to my $275 March Choice cutout forecast is to the downside and recognize that it could be way south of what I currently have dialed in. In contrast to all of the uncertainty surrounding the demand side of the market, the supply side seems pretty well behaved. This week's fed kill came in at 512k, up 2k from the week before and a good bit larger than what past placements indicated for February. Perhaps packers are cleaning up some of the cattle that were backlogged during the Omicron wave. They need to do something, because the cattle are getting excessively heavy.

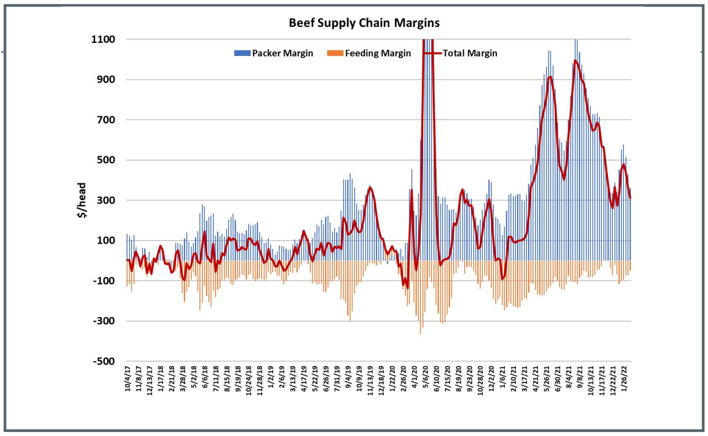
Steer carcass weights were reported up 3 pounds this week to 930 pounds, which was one pound heavier than the peak that was registered back in early December. The normal seasonal pattern is for carcass weights to trend lower from November to April, so this is highly unusual. Further, the DTDS weights have moved to a very high level. That seems to suggest that feedyards are not current at present. However, that doesn't seem to have affected feedyard's negotiating position with packers since cash prices have been working higher over the past couple of months. One thing is for sure: bigger-than-expected kills and very heavy carcass weights will result in a lot of beef tonnage that needs to clear the market next week. That is generally not helpful when demand is in a downcycle. International demand seems to be in decent shape, but it isn't stellar enough to save the market from a domestic consumer that is shying away from high retail beef prices and has other things to do now that the pandemic is winding down.

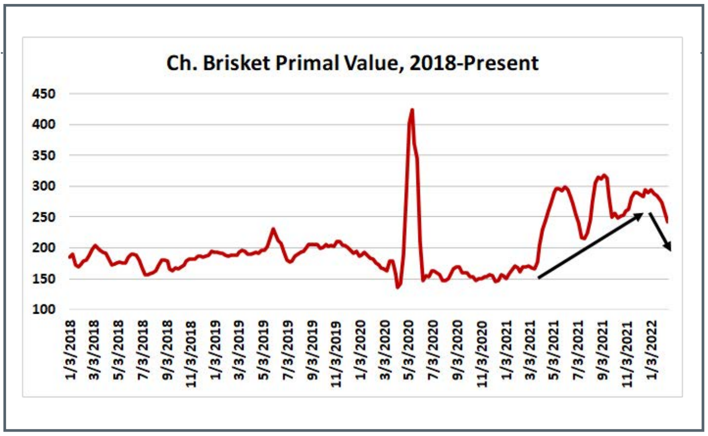
Even the futures market seems to now be having its doubts. Traders have been flattening out the futures curve recently. This week the nearby Feb contract was up the most as it kept pace with the rising cash market, but the deferreds were up less. It is entirely possible that at some point in the near future a basis shift happens and causes the futures curve to invert. I think that is likely to happen the first time cash trades solidly lower from the week before. Large speculators have built a pretty sizable long position in live cattle futures under the hope that persistent inflation will cause cattle prices to continue to rise, but if the curve shows signs of inversion, they may head quickly for the exits and remove a lot of what has been supporting futures lately. Next week, watch the cutout values to see how well the market digests this week's large production and keep an eye on those brisket prices–they might be trying to tell us something.


WTD Change in LC Futures
1.600
1.400
1.200
1.000
0.800
0.600
0.400
0.200
0.000
-0.200
-0.400
Feb22
Apr22
Jun22
Aug22
Oct22
Dec22
Feb23
Apr23


WTD Change in FC Futures
2.000
1.500
1.000
0.500
0.000
-0.500
-1.000
Mar22
Apr22
May22
Aug22
Sep22
Oct22
Nov22


Weekly Avg Primal Impact on Choice Cutout from W/E Feb 11, 2022 to W/E Feb 18, 2022
Cutout Chg = -6.43
$/cwt.
0.00
-0.50
-1.00
-1.50
-2.00
-2.50
-3.00
-3.50
-4.00
-4.50
-5.00
-0.50
-4.37
-0.59
-0.09
-0.42
-0.46
Rib
Chuck
Round
Loin
Brisket
50s


Beef Supply Chain Margins
Packer Margin
Feeding Margin
Total Margin
$/head
1100
900
700
500
300
100
-100
-300
-500


Ch. Brisket Primal Value, 2018-Present
450
400
350
300
250
200
150
100
1/3/2018
3/3/2018
5/3/2018
7/3/2018
9/3/2018
11/3/2018
1/3/2019
3/3/2019
5/3/2019
7/3/2019
9/3/2019
11/3/2019
1/3/2020
3/3/2020
5/3/2020
7/3/2020
9/3/2020
11/3/2020
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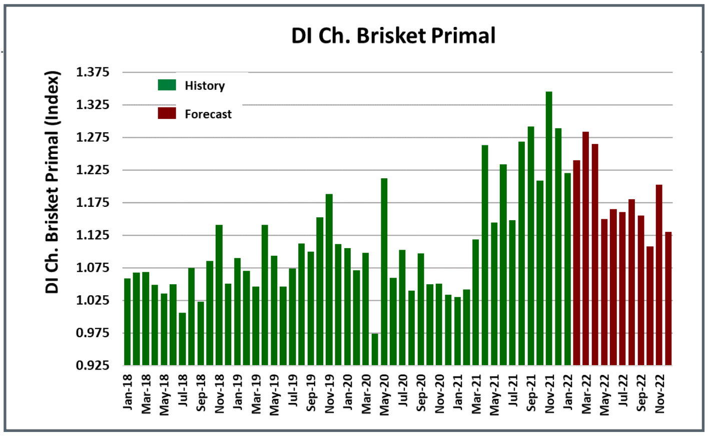
9/3/2021
11/3/2021
1/3/2022


DI Ch. Brisket Primal
History
Forecast
DI Ch. Brisket Primal (Index)
1.375
1.325
1.275
1.225
1.175
1.125
1.075
1.025
0.975
0.925
Jan-18
Mar-18
May-18
Jul-18
Sep-18
Nov-18
Jan-19
Mar-19
May-19
Jul-19
Sep-19
Nov-19
Jan-20
Mar-20
May-20
Jul-20
Sep-20
Nov-20
Jan-21
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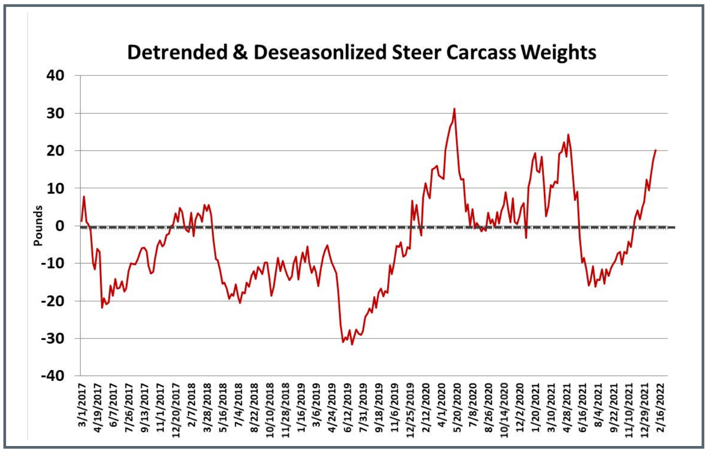
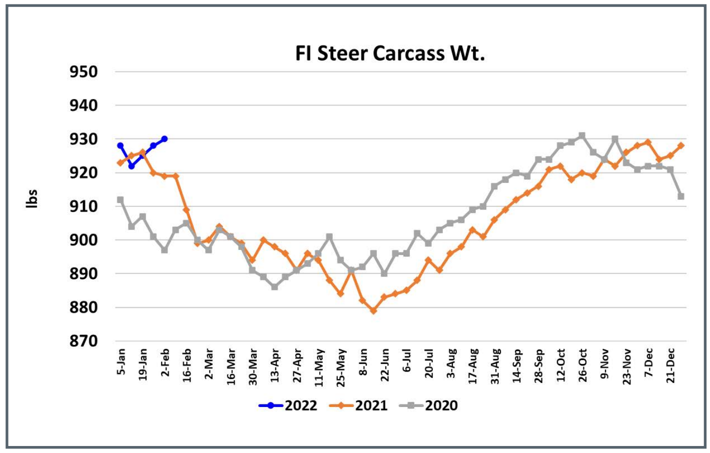
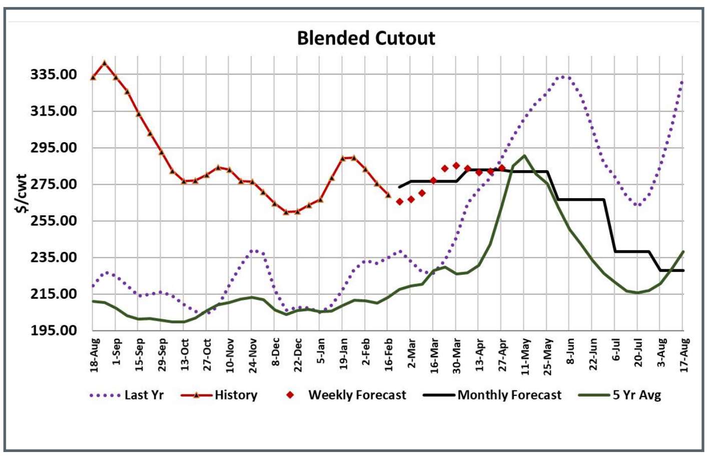
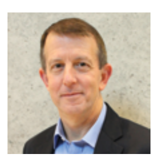
May-22
Jul-22
Sep-22
Nov-22









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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.

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