



WEEK ENDING JUNE 24, 2022

# THE PORK WRAP

Things continued on an upward trajectory this week in the hog and pork complex as the negotiated hog markets averaged about \$2.50/cwt higher and the cutout managed to eek out a \$0.80 gain. The notable event of the week was a sharp drop in the futures on Thursday without any significant change in the fundamentals. The Jul contract lost \$3.30 on Thursday and the Aug contract finished \$4.65 lower as the hog market got caught up in a big sell-off across most of the commodity markets. Traders soon realized the error of their ways and the market bounced back sharply on Friday. The LHI currently sits at \$110.90 with three weeks until expiration. Prior to Thursday's sell-off, the Jul futures had been carrying a small premium to the LHI, but now the futures are almost dead on the index. The bears seem to be getting a little nervous, and with good cause, as the industry will soon be moving into the smallest kills of the year. The July 4 holiday, because it falls on a Monday, will result in a very small Saturday kill next week. Then comes the actual holiday week itself when the Monday harvest will be zero.

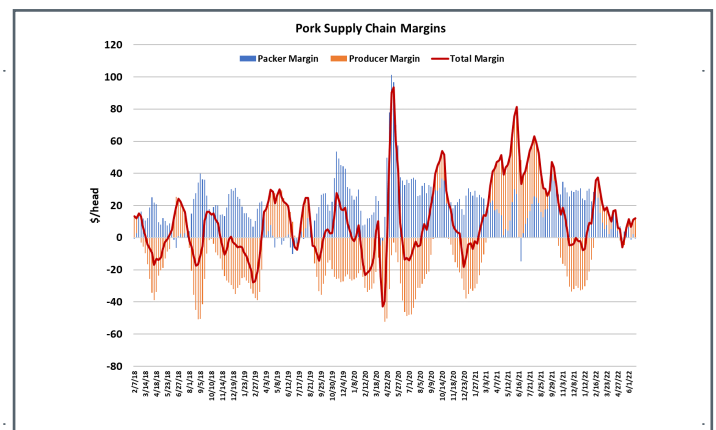
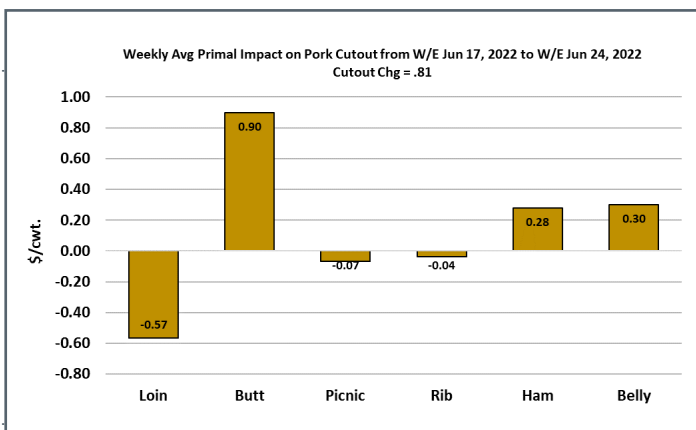
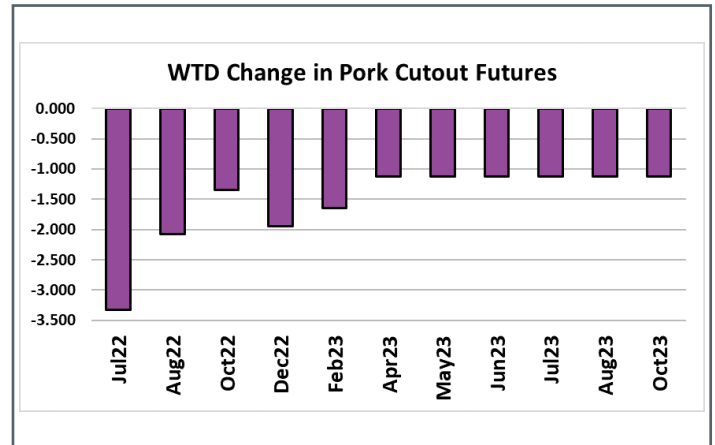
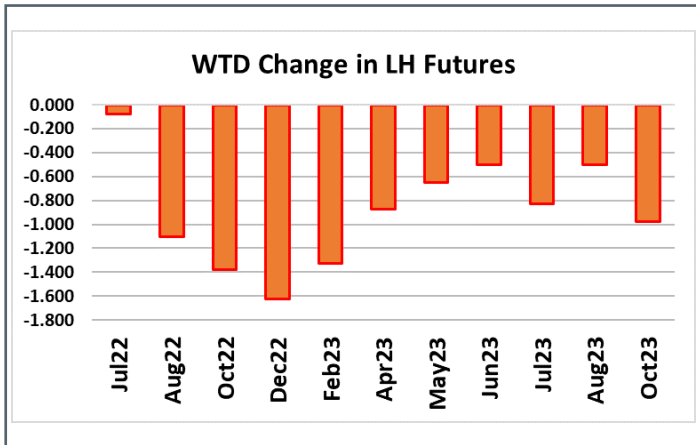
By the time those two short production weeks are behind us, the Jul contract will only be a few days from expiration. My thought has been that the cutout will hold steady over \$110 over the next couple of weeks and then decline as production ramps back up following the holiday week. I have fair value for the Jul contract currently pegged at \$109, but I could be too low on that. Pork demand seems to be holding up fairly well as we head toward July. The combined margin is still moving higher, but this week's gain was very small. A lot will depend on how well buyers are prepared for the upcoming holiday. If they haven't sourced enough product and have to scramble to procure more then that would show up as further demand strength. If they are adequately bought, they might not need to bid up the pork market and thus we could see demand plateau or turn lower. In either case, the combined margin sure looks like it is set to make a top soon. Whether that comes before or after July 4 remains to be seen. USDA did provide a cold storage update this week that showed total pork in cold storage up 17% YOY.

Cold storage stocks are not yet back to pre-pandemic levels, but they are headed in that direction. Bigger stocks give buyers an alternative to the spot market when cash prices get high and thus they tend to have a price-depressing effect. Now that a lot of the uncertainties surrounding the pandemic have faded, pork users seem to be more confident in holding larger inventories in cold storage. Once again, it was the butts that provided most of the lift to the cutout. I haven't found a satisfactory explanation for why the butts are so strong right now, but the attached scatter between the butt primal and its close cousin, the picnic, indicates that butts are indeed extra strong this June, but not nearly to the degree that they were last year. Hams and bellies also provided some modest support this week and we saw the 23/27 hams trade over \$100 for a while.

The bellies have been creeping slowly higher on a weekly average basis, but the averaging process helps mask some big price swings on a daily basis. I see both hams and bellies keeping firm pricing over the next week or two as production will be light. After that, both could be vulnerable to a downturn. This week's kill clocked in at 2.3 million head, which is about 2% below last year. Next week's kill should be even smaller, perhaps around 2.28 million head and then for the holiday week I'm expecting the kill to drop to 2.05 million head. This week's slaughter was just a bit larger than what the pig crop suggested, but if we look at the first four weeks of the quarter taken together, the deviation from the pig crop is almost zero. So it looks like USDA may have nailed this pig crop right on the head and thus I can be pretty confident about forecasted slaughter levels in July and August. After the week of July 4, kills should start to slowly expand and by the first week of August, they could be back up to 2.4 million head per week. By the end of August, we might see 2.5 million head per week.

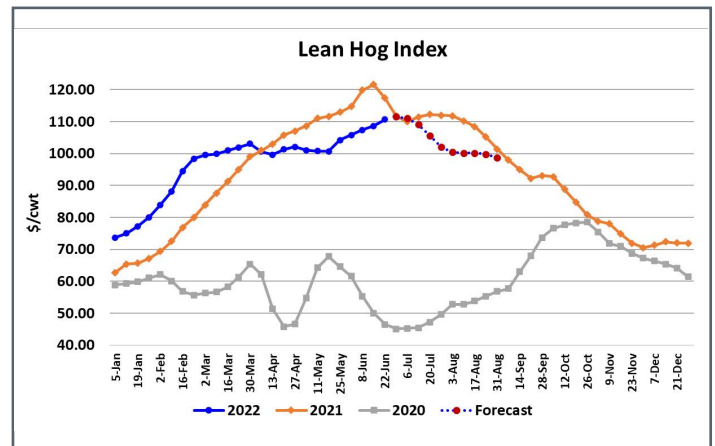
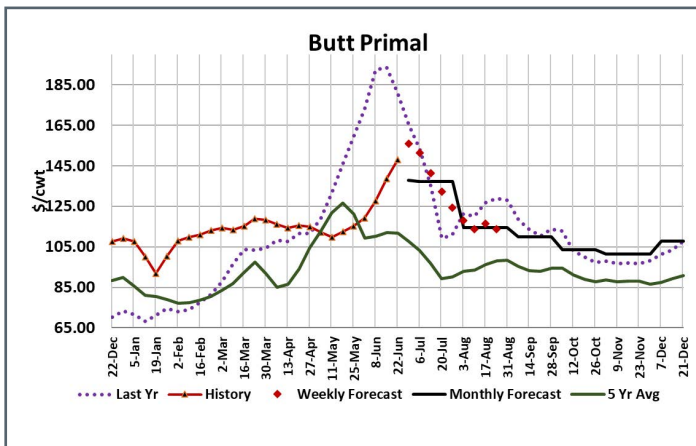
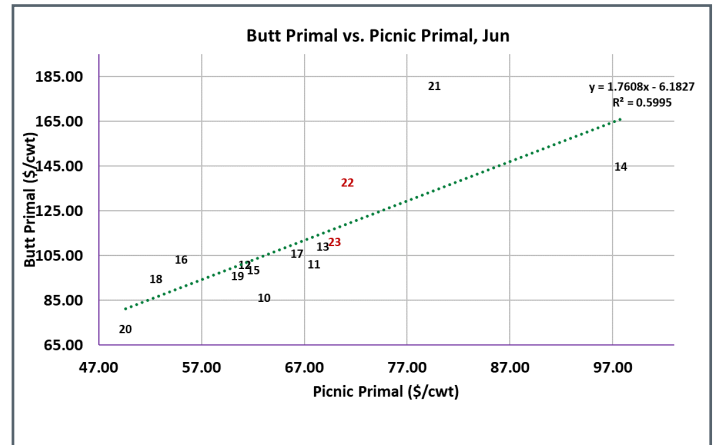
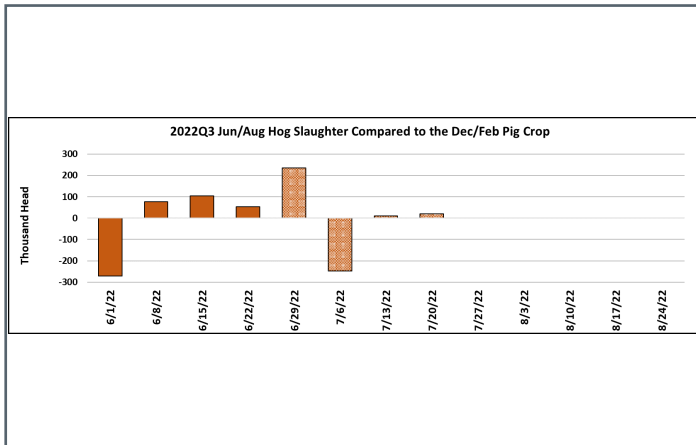
Of course now that we are right on the verge of the smallest kills of the year, packer margins are under pressure as they are forced to compete more aggressively for what few hogs might be available to fill out their kill schedules. Packers have bid up hog prices to the point where negotiated prices are only a couple of dollars below last year's strong showing in the low \$120s. I calculate this week's packer margin at -\$0.60/head and expect that it will get more negative next week. Look for packer margins to remain close to, or just below zero through July. By August, they should be expanding again and could average around \$5-7/head. Hog weights continue to behave normally, declining seasonally as expected. The heat dome that had been forecast to appear over the Midwest never materialized and so that has helped to mitigate the near-term supply side risk. We should remain vigilant about the weather however because summer is still young and there will be plenty more opportunities for a heat wave to cause rapid weight loss in market hogs.

USDA will release the next issue of its Hogs and Pigs report on Wednesday and I'm looking for it to show a steady to slightly smaller hog herd compared to what they reported back in March. There is not much financial incentive for producers to expand in this high cost environment and I'd say that if there is a surprise in next week's report it may be that hog numbers are smaller than the pre-report estimate. We all know how much futures traders love a bullish Hogs and Pigs report. The other area where a potential surprise could develop is in the belly market. Last year around this time the bellies crashed hard, taking the cutout, and eventually cash hogs, down. I think the probability of that happening this year is much lower, mostly because belly prices are not elevated nearly to the degree that they were last year. Volumes moving into export have been pretty steady over the past couple of months, but they are still below last year's level. At current pork prices, it is hard to imagine that exports will provide any surprises in the near-term. Next week, watch the weather in the Midwest and keep an eye on butt prices because if they start to break it will likely pressure the cutout lower.



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