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WEEK ENDING SEPTEMBER 9, 2022

THE PORK WRAP

The pork cutout advanced a tiny bit this week, gaining $0.79 to average $103.20/cwt. That gain stands in sharp contrast to prices in the hog market, which were sharply lower. The WCB negotiated market dropped $6.49/cwt this week and the LHI lost $5.80/cwt. The LHI has now lost $15 in just 2 weeks. One might think that would have futures traders shorting the Oct contract with both hands, but I think they realize that the sharp drop in the LHI was just a correction in response to the big drop in the cutout since late August. In essence, hog prices are moving down to a level that will give packers a positive margin once again. I estimate this week's margin at about $3.50/head, which is a huge improvement over the -$10/head margins they had last week. A typical packer margin at this time of year is in the $10-15/head range and so the cash hog markets might continue to slide until margins move to that level. Most of that may be accomplished next week.

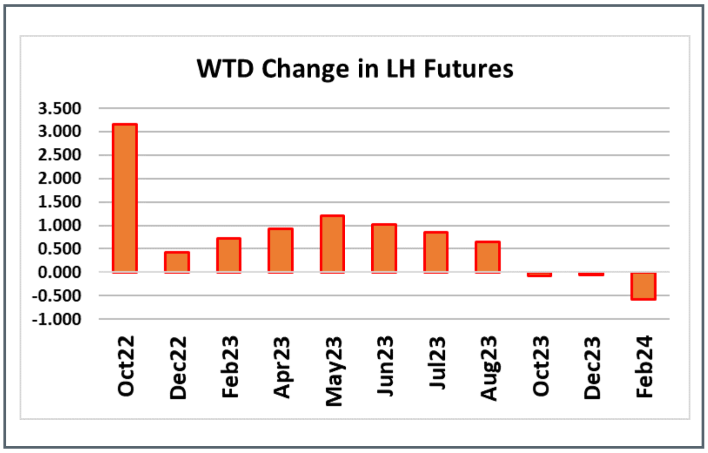
Why are futures traders not panicking then? I think it has a lot to do with the cutout. It has been wallowing around in the low $100s for almost 3 weeks now and there is a seasonal tendency for the cutout to increase in the second half of September as buyers gear up for pork month features in October. That, plus the fact that they are seeing hams strengthen and bellies at such a low level that it seems like some strengthening in that primal is eminent. That gave futures traders enough confidence to add a little over $3 to the Oct contract this week. The shift in the basis has been dramatic. Shortly after Aug expired and Oct became the front month, the futures were trading at a $26 premium to the LHI. Today, that premium is only about $6. Keep in mind that the Oct contract has five weeks left to trade. After watching the basis narrow almost $7 per week over the past three weeks, traders now think that the basis will only narrow about $1 per week for the next five weeks. That seems pretty bold.

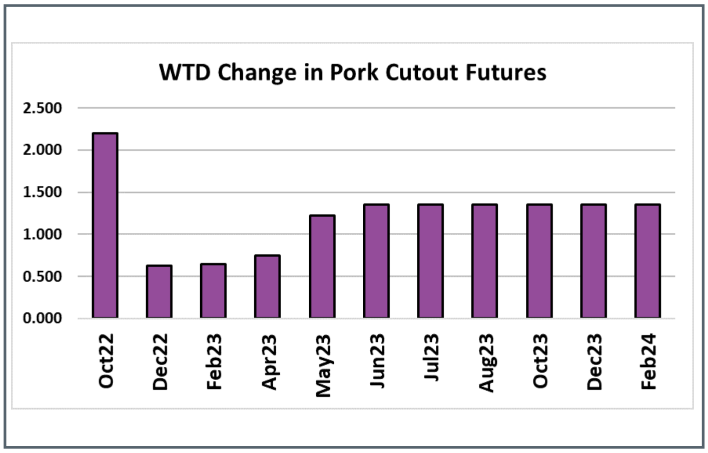
Last year at this time the basis for the Oct contract was almost $15. The key difference lies in the cutout. Last year, in the second week of Sep, the pork cutout was at $107 and the pork cutout futures for Oct expiration were trading near $98. So, traders expected the cutout to keep falling. This year, the pork cutout is at $103 and the Oct cutout futures are also at $103, which means traders aren't looking for any further erosion in the cutout. That makes a big difference to expectations for the LHI. Now, of course, traders could be really wrong in assuming that the cutout will hold steady for the next five weeks, but the current pricing environment for the primals suggests that a steady, or perhaps even a modestly rising, cutout between now and the middle of October is possible. It has been very encouraging to see the ham primal turn higher and everyone knows that it is very difficult to move the cutout significantly lower without help from the hams.

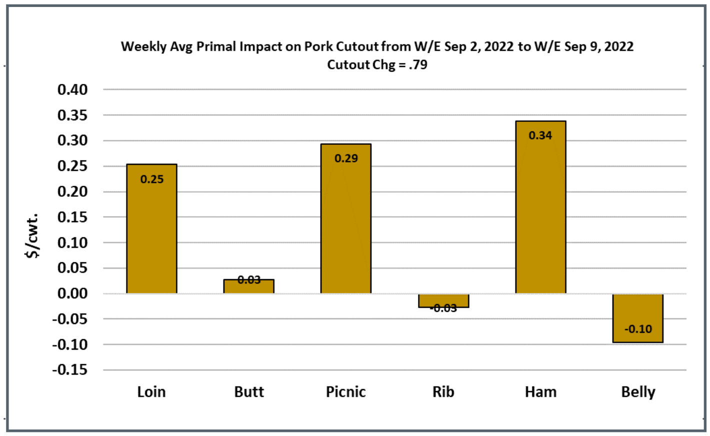
Bellies are the other big cutout mover and after freefalling the past few weeks, the belly primal seemed to stabilize this week (down less than $1 from the week before). Everyone also knows that the one thing bellies rarely do is stay flat. They are either moving up or down and often in a big way. It looks like it is time for some recovery in the bellies and if that happens then the cutout likely moves higher. My forecast has the cutout inching back up to $105 or so over the next couple of weeks, mostly on gains in bellies. Hams, I think are going to stall in the low $100s on the primal, but not ease much in the near term. Eventually, the cutout will be pressured below $100 as production increases seasonally, but I think it stands a decent chance of remaining above $100 until near the end of September. My call for the cutout at Oct expiration is around $96, so the current level of Oct cutout futures is probably too high, but that might not become evident for several more weeks. And, there is always the chance that the bellies and hams will garner more strength that I currently have dialed in and thus help move the cutout back toward $110.

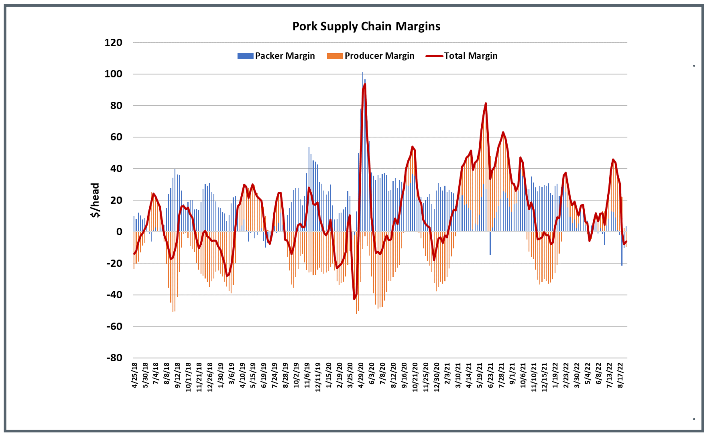
We know that supplies will be increasing seasonally from now until early December, so the real unknown is how demand will perform this fall. In the last couple of years we have seen strong demand surges around late Sep/early Oct and that may be part of what traders are counting on. The combined margin ticked higher this week and is in the right zone to be indicating a bottom. I want to see another week of data before declaring the bottom is in, but it does look as though the market could be entering a upcycle in demand soon. This week's holiday-shortened kill registered 2.24 million head, with packers killing 317k on Saturday in an effort to make up some of Monday's lost production. Next week's full kill could be close to 2.5 million head, so there should be more product available and that is a big reason that I don't have stronger cutout increases dialed in. However, once we hit that 2.5 million head mark, further slaughter increases should be relatively small and our peak slaughter in late November should be close to 2.6 million head.

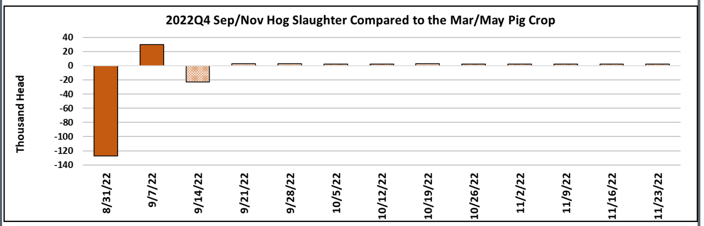
Hog weights are on the rise seasonally, but are not out of line with past years and it doesn't look like hogs are backing up in the pipeline. So, if demand can hold up enough to get the market through the next couple of weeks without serious concession in the cutout, then it will escape the biggest escalation in supply. And, it is always possible that USDA over-estimated the Mar/May pig crop like they did for the Dec/Feb pig crop that was killed this summer. The dark spot in the complex comes from international demand, which is still struggling. The ERS export totals for July were down almost 5% YOY and my guess is that August will be down a similar amount. The slowdown from China has left a big hole in export prospects. Next week, watch for signs of price recovery in the bellies since that is the single biggest thing that could help the cutout and strengthen the bulls. Expect further weakness in negotiated prices as the market adjusts to provide packers with a more-normal margin for this time of year.

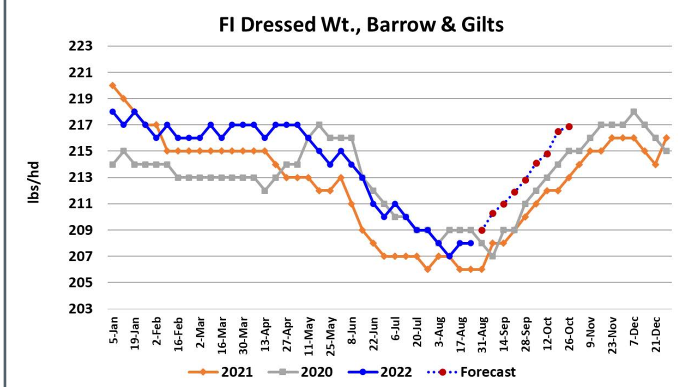

WTD Change in LH Futures
3.500
3.000
2.500
2.000
1.500
1.000
0.500
0.000
-0.500
-1.000
Oct22
Dec22
Feb23
Apr23
May23
Jun23
Jul23
Aug23
Oct23
Dec23
Feb24

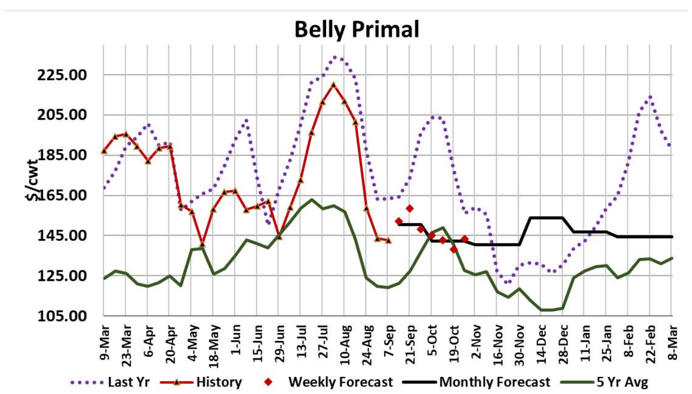

WTD Change in Pork Cutout Futures
2.500
2.000
1.500
1.000
0.500
0.000
Oct22
Dec22
Feb23
Apr23
May23
Jun23
Jul23
Aug23
Oct23
Dec23
Feb24

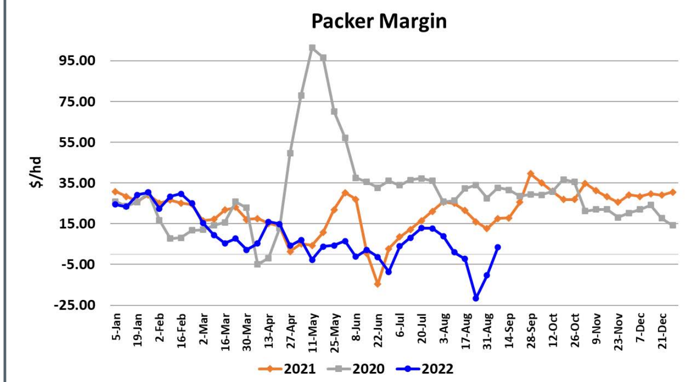

Weekly Avg Primal Impact on Pork Cutout from W/E Sep 2, 2022 to W/E Sep 9, 2022
Cutout Chg = .79
$/cwt.
0.25
0.03
0.29
-0.03
0.34
-0.10
Loin
Butt
Picnic
Rib
Ham
Belly


Pork Supply Chain Margins
Packer Margin
Producer Margin
Total Margin
$/head









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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.