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WEEK ENDING OCTOBER 7, 2022

THE PORK WRAP

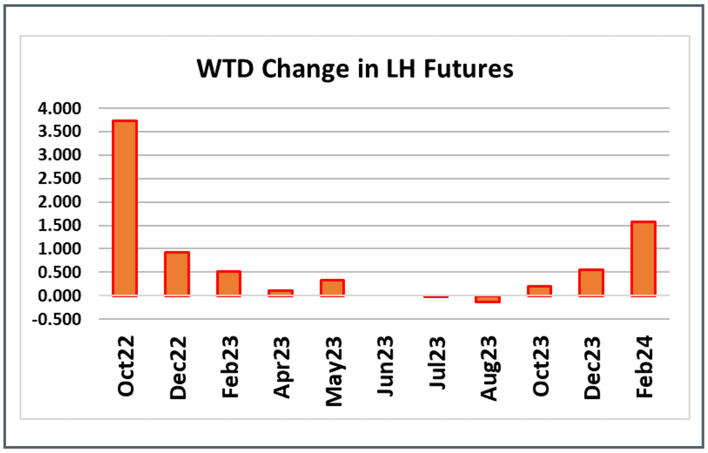
After trending lower for the past couple of months, the pork cutout managed a small gain this week, adding $0.57 to average just over the $100 mark. Cash hog markets were a little weaker, with the WCB negotiated market dropping $1.74/cwt. on a weekly average basis. With pork moving up slightly and cash hog prices moving lower, packer margins expanded out to about $13/head. That represents about a $7 spread between the cutout at $100 and the LHI which is now close to $93. Perhaps the most surprising feature of this week's market happened in the futures, where traders beat down the nearby Oct contract to below $87 on Tuesday only to realize that was a significant mistake and thus the contract rallied $6 over the next three days to finish the week just a hair below $93. I'm not really sure why traders felt the need to sell Oct so hard when it was so close to expiration (next Friday), because the rate of decline in the LHI suggested that there was very little chance that the index would drop to $87 in just eight trading days.

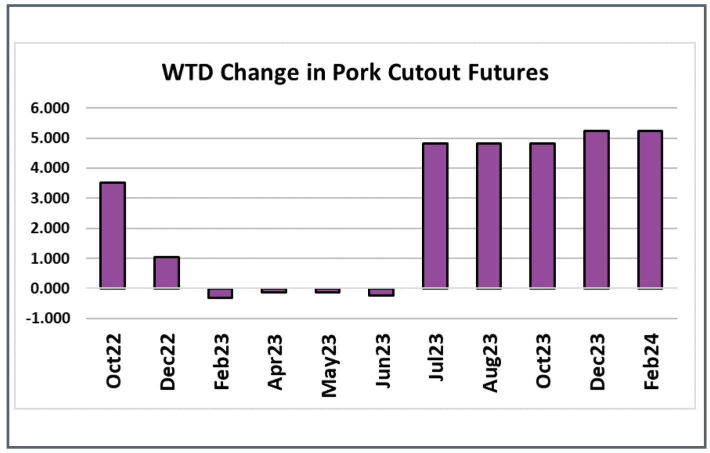
Part of what prompted the turnaround in the futures was some strengthening in the cutout, which moved from below $99 early in the week to over $101 for the last two days of the week. Those gains were largely driven by stronger belly and ham pricing. Just when I thought that the strength in the hams had finally topped, the primal was able to add more than $2 this week. I'm a little uncertain as to where the hams go next. Growing production and the narrowing window to get hams processed in time for the holidays suggests that ham prices should work lower, but those conditions have been in place for a few weeks now and we have yet to see any meaningful weakness in ham prices stick. They may get pushed lower for a few days, but they always seem to resurrect. I'm going to keep the forecast on a slight downward trajectory for now, but recognize that hams are probably going to stay well above last year for most of Q4.

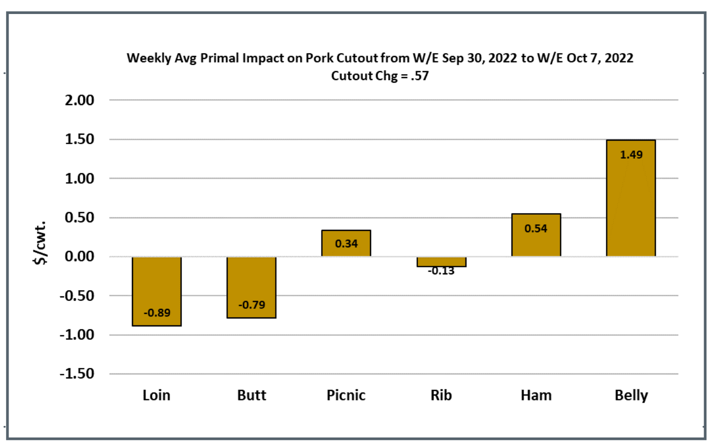
With respect to the bellies, I've been suggesting for the past few weeks that they were due for an upward move and this week the belly primal managed to add almost $8/cwt. Belly prices are still quite low relative to recent history, so perhaps this week's gains will cause some buyers to get off of the fence and break out the checkbook. I don't think a huge price rally is in the cards for bellies, but they may be able to build on this week's rally for a couple of more weeks before growing production moves them lower again. One thing that gives me some hope for further gains in the bellies is that trim prices have been holding up rather well recently and there is normally a pretty strong correlation between trim prices and belly prices. On the losing end of the spectrum this week was the retail items, particularly loins and butts. The butt primal lost about $6 on a weekly average basis and the loin - primal was down about $2.50/cwt. These are the items that pork month promotional incentives were designed to support, but even a well planned industry promotion can't always overcome the negative effects of seasonally increasing pork production. I'm looking for the cutout to average just over $100 again next week on further belly strength and then start to slip slowly lower until it is near $90 in mid-to-late November. Last year, the cutout lost $23 from early October until mid-December and that may be influencing the way that futures traders are pricing the Dec contract, but that big drop was a bit of an outlier. Usually a decline of $4-6/cwt is more common. I'm going to stretch that a bit and call it down $10-12 this year, but I can't find a plausible scenario where it loses $23. It does seem like traders have been overly negative on the Dec contract and it finished today more than $15 below the Oct contract and close to $77. My read on the fundamentals suggest that $83 would be a better choice for Dec.

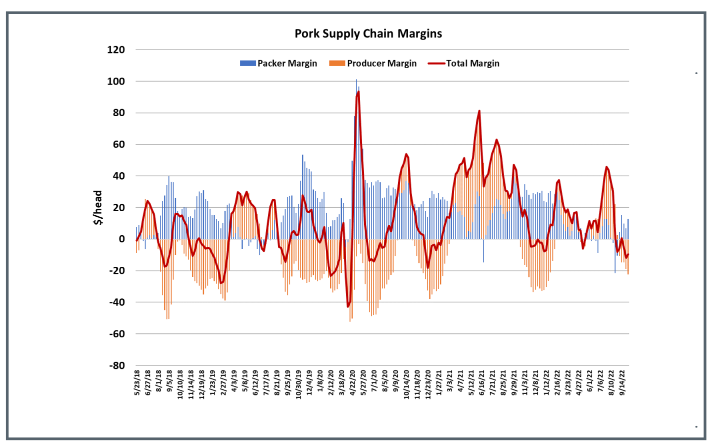
It might even outperform that because the combined margin is acting like it wants to bottom again and if that holds, we could see a much flatter trajectory in the cutout and LHI than the futures currently imply. I'm not ready to call this week's little uptick in the combined margin a bottom, but it sure seems like it is in the right zone for it. Next week's data should help clarify. This week's kill registered 2.56 million head and that was a little larger than what the March/May pig crop implied. As we approach the halfway point in Q4, it looks like the industry has underkilled the pig crop by about only 100,000 head. It's not a big miss, but it makes me think that perhaps there are just a few less pigs out there than what USDA projected for the Sep/Nov quarter. The industry will start killing the summer pig crop come December and that was estimated to be 1.1% below last year. So, YOY production declines are dialed in for the next few months unless the survey missed a lot of pigs. Barrow and gilt weights were steady at 210 pounds this week, marking their third week in a row at that level.

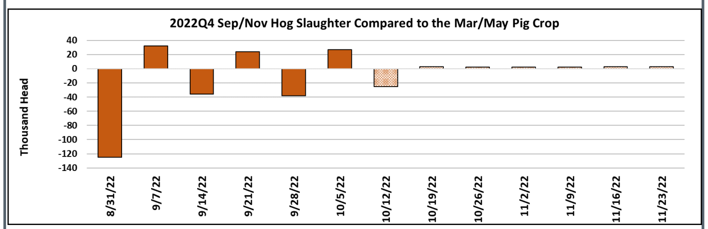
The uptrend in weights should continue next week and probably won't top until mid-November or later. There isn't anything in the weight data to suggest that the production pipeline is experiencing any problems. Export data for August became available this week and it showed a 2.6% YOY decline. Movement to China was actually up about 9% YOY, but that is only because we are now lapping the point where exports to China dropped off a cliff last year. Mexico is looking like the most promising destination at moment that probably says a lot about why the ham market has performed so well this year. The US dollar hasn't appreciated against the peso to near the degree that it has against other currencies, so Mexican buyers have an advantage there. Imports remained elevated in August, up 2% from last year and about 9% stronger than in July. Next week, watch for further strength in the bellies–it will be needed if the cutout is to hold above the $100 mark.

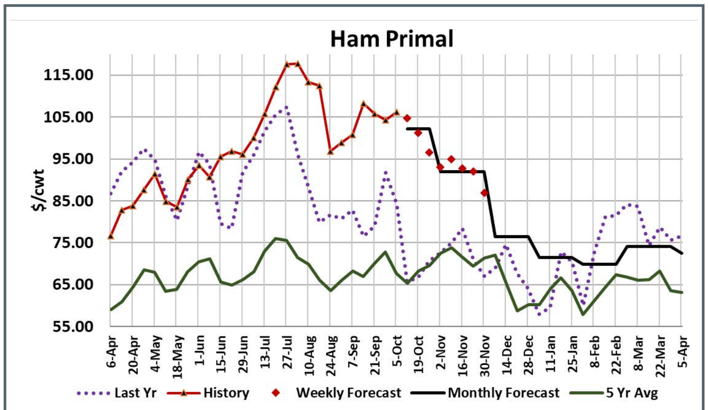

WTD Change in LH Futures
4.000
3.500
3.000
2.500
2.000
1.500
1.000
0.500
0.000
-0.500
Oct22
Dec22
Feb23
Apr23
May23
Jun23
Jul23
Aug23
Oct23
Dec23
Feb24

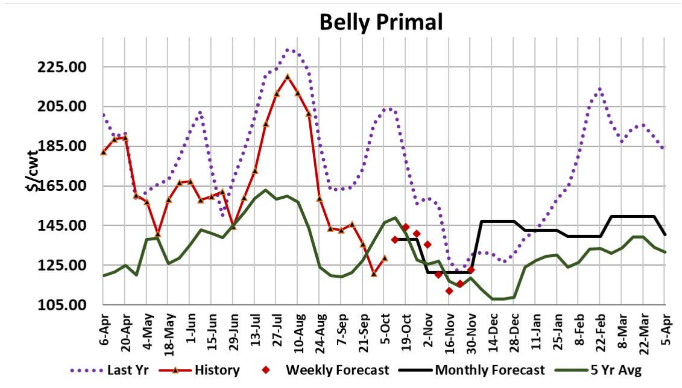

WTD Change in Pork Cutout Futures
6.000
5.000
4.000
3.000
2.000
1.000
0.000
-1.000
Oct22
Dec22
Feb23
Apr23
May23
Jun23
Jul23
Aug23
Oct23
Dec23
Feb24

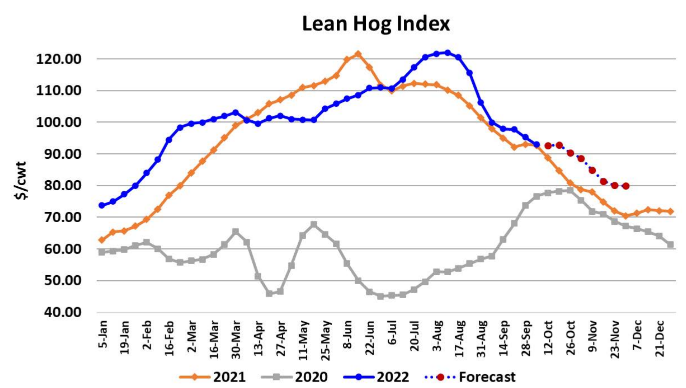

Weekly Avg Primal Impact on Pork Cutout from W/E Sep 30, 2022 to W/E Oct 7, 2022
Cutout Chg = .57
$/cwt.
2.00
1.50
1.00
0.50
0.00
-0.50
-1.00
-1.50
-0.89
-0.79
0.34
-0.13
0.54
1.49
Loin
Butt
Picnic
Rib
Ham
Belly


Pork Supply Chain Margins
Packer Margin
Producer Margin
Total Margin
$/head
120
100
80
60
40
20
0
-20
-40
-60
-80









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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.