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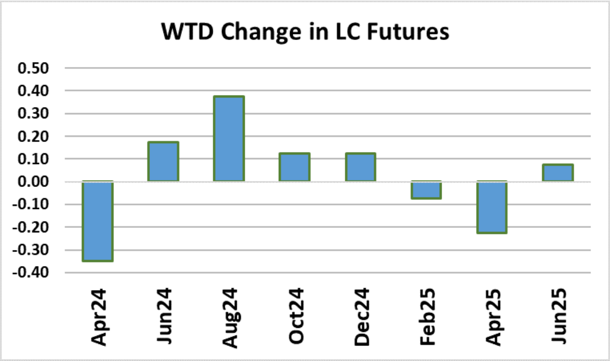
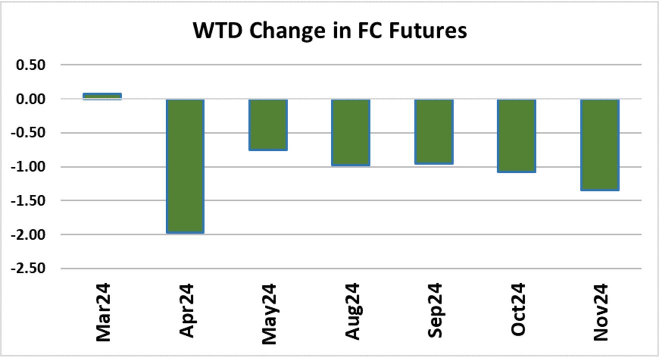
WEEK ENDING MARCH 15, 2024

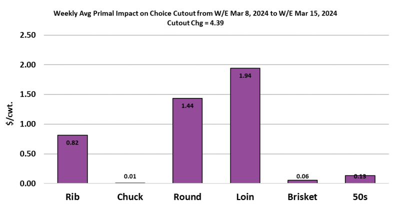
THE BEEF WRAP

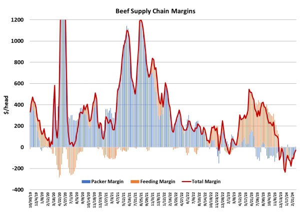
Light kills in the past few weeks has made it easier for packers to keep upward pressure on the cutouts. This week, the Choice cutout gained $4.39 on a weekly average basis in moving to $310.39 and the Select cutout added $4.52 on its way to $300.72. Unfortunately for them, they ended up paying more for cash cattle once again, which will work to offset the beef price improvement and thus their margin gains will be small. The cash cattle market advanced a little over $2 and the national average live price is likely to print near $187.30 once all of the data is tabulated on Monday. Once again, futures traders were not impressed with the advancement of the cash cattle market. In the last two weeks, the cash market has gone from $183 to over $187, yet the Apr futures are actually down $1.20 over that same period. This, of course, has caused a big shift in the basis, going from futures well over cash to the current situation where Apr futures are now nearly dead-even with cash. Why do futures traders seem to be losing faith in the future at a time when cash is steadily advancing? I think a lot of it has to do with what has been going on with fed kills and carcass weights, so let's dig into that a bit. Everyone is well aware that packers have been restraining the fed kill and the assumption has been that is because their margins are in the red. However, this week's packer margin is -$35/head and while that is not good, it certainly isn't a terrible margin. Back in the middle of February, packer margins were -$123/head. There have been times in the past where packer margins have been close to $200/head in the red. Rather than pointing to the usual margin explanation, what if fed kills have been small because fed cattle availability is tight? No one seems to be considering that possibility. But how can fed cattle availability be tight when the data clearly shows a sharp counter-seasonal increase in carcass weights? Doesn't that mean that cattle are backing up? Yes, it does, but what if cattle feeders want cattle to get a lot heavier and thus they are purposefully withholding cattle from the packer each week? Take a look at the attached YOY chart of steer weights, which I've embellished with some additional lines this week. Note that in the first week of 2024, steer weights were almost 20 pounds over last year. Also note that this actually began back in late 2023 (the circle). In early January, the polar vortex caused a sharp reduction in carcass weights. Maybe this recent counter-seasonal move higher in weights has simply been an effort by the cattle feeder to get back to that "20 over last year" level (the light blue line). One thing to note is that while weights are certainly heavier than last year, last year they were very light. Weights are now at par with 2022, so not all that heavy in a historical context. Why would a cattle feeder want his animals to be heavier than last year? Well, for one thing, corn is a lot cheaper than it was last year at this time. USDA is reporting cash corn prices in SW Kansas at $4.47 a bushel. Last year at this time they were $7.51 per bushel. So, the cost of making cattle heavier has gone way, way down. Second, replacement feeder cattle are very expensive. This week the CME Feeder cattle index averaged $248/cwt. and last year it was at $183/cwt. With replacement costs so much higher and feed prices so much cheaper, wouldn't it make sense to keep the cattle that you already own for longer, thus making them heavier? Yes, of course it would. So, one way to look at the this counter-seasonal increase in weights is that cattle feeders are just "undoing" the damage that was done by the weather in January and working back towards a "20 lbs over last year" scenario, which was their intention all along.

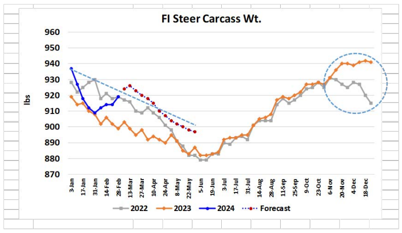
Ok, that sounds reasonable, but what is going to happen when they get back to the desired weight level? Isn't there a risk that packers will continue run small kills, thus causing them to overshoot on weights? That is definitely a risk and one that futures traders will be watching closely. However, this is where spring demand comes to the rescue. In two weeks, April will be upon us and demand should be improving. Over the last month or so, the gains in the cutout have been largely a result of smaller supply, not demand improvement. We can see this in the attached weekly scatter of the blended cutout vs weekly load counts. In this scatter, over the last few weeks, the demand curve has been relatively stable while the supply curve has moved leftward (reflecting smaller production). When the demand curve starts to shift rightward due to improving demand this spring, one of two things will happen. If packers keep the kill at these low levels, beef prices will skyrocket higher or, if packers expand the kill (move the supply curve downward and to the right) then prices will advance more moderately. Which is more likely? I'd say the second scenario because once demand starts improving, prices will rise, packer margins will get better, and then they won't be able to resist expanding the kill. By then, cattle feeders will have attained their carcass weight goal and will be happy to let go of more cattle, thus keeping weights from getting obscenely heavy. Ok, so what does that mean for cattle and beef pricing? Beef prices would work higher at a moderate pace, but not skyrocket, and cattle prices might slow their advance because cattle feeders are willing to open the gate a little wider. However, one thing that would not happen is a total collapse in the cash cattle market, which seems to be what a lot of traders are banking on as they watch weights move counter-seasonally higher right now. Of course, all of this relies on the assumption that beef demand will start to improve seasonally in the next few weeks. Without that, we could certainly see cattle prices collapse because there would be no incentive to expand the kill and thus cattle might get obscenely heavy, forcing cattle feeders to puke them up. I think that demand not improving this spring is a very low probability event, but it could happen. I can't think of many years where middle meat demand and prices didn't advance in the spring. But what about end meats, will that demand improve? Well, if we look at what is going on in the lean trimmings market (chart attached), it's hard to believe that demand for end meats won't be positively influenced since those items can be ground and substituted for very expensive 90s. This week's fed kill registered 477k, up 20k from the week before. The Saturday fed kill was likely over 10,000 head when it had been running almost nothing. So, it looks like packers are already being tempted to expand the kill. They feel the spring demand coming, I think. You don't crater the cattle market by expanding the kill. Another bullish indicator that I noticed this week came on Thursday when the futures sold off hard. Why is that bullish? Because cattle feeders didn't immediately start dumping cattle at lower prices in the cash market. They maintained their discipline and it paid off. If you remember last fall when the market moved into a big downtrend, cattle feeders were easily influenced by sharp down days in the futures. I'm not seeing that in the current market. Sorry to waste so much ink this week on one topic, but small kills and weights had become the elephant in the room that couldn't be ignored. I can't guarantee that the scenario I've proposed is correct, but I do think it stands on solid economic underpinnings. To many, the recent market has seemed to defy logic. In my experience, when that happens, it is time to consider a different logic.

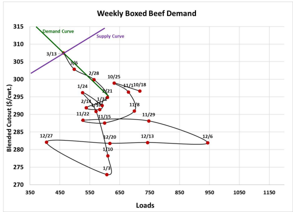

WTD Change in LC Futures
0.50
0.40
0.30
0.20
0.10
0.00
-0.10
-0.20
-0.30
-0.40
Apr24
Jun24
Aug24
Oct24
Dec24
Feb25
Apr25
Jun25

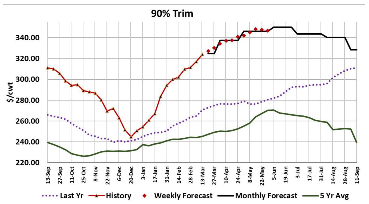

WTD Change in FC Futures
0.50
0.00
-0.50
-1.00
-1.50
-2.00
-2.50
Mar24
Apr24
May24
Aug24
Sep24
Oct24
Nov24

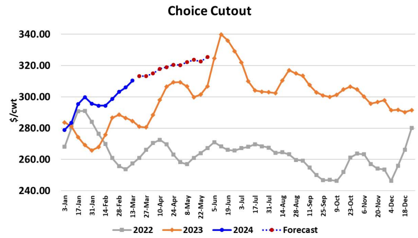

Weekly Avg Primal Impact on Choice Cutout from W/E Mar 8, 2024 to W/E Mar 15, 2024
Cutout Chg = 4.39
$/cwt.
2.50
2.00
1.50
1.00
0.50
0.00
0.82
0.01
1.44
1.94
0.06
0.13
Rib
Chuck
Round
Loin
Brisket
50s


Beef Supply Chain Margins
$/head
1200
1000
800
600
400
200
0
-200
-400
Packer Margin
Feeding Margin
Total Margin









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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.