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RETAIL READY Foods Inc. | J.S. FERRARO & COMPANY

THE MONTHLY

MARCH 2019

RED MEAT OUTLOOK: CATTLE & BEEF

The US cash cattle markets pressed higher during February, with price levels reaching $128 near the end of the month, up about $5 from where they finished in January. The Choice cutout gained about $4 while the Select cutout was unchanged. February is typically a poor month for beef demand and the fact that the cutout was able to advance over the course of the month is a testament to robust domestic demand. We have been monitoring the weather across cattle feeding country it looks like feedlot conditions deteriorated in the northern states, but they may have improved somewhat in the southern areas. In addition to precipitation causing muddy feedyards, some very cold temperatures were also recorded in the north, which further hampered cattle performance. Cattle feeders gained some leverage with packers in their weekly haggling over cash prices since cattle weights are down and they had no problem holding the cattle a little longer if packers did not agree to higher prices. The result has been a slow, steady grind higher for cattle prices and that is a trend that may continue through March. Packers have remained profitable, with margins averaging about $63/hd during February. That is a bit unusual because quite often packer margins are at their worst, and often negative, during the chilly days of February. Cattle feeding margins also improved as cash cattle prices climbed, but it is likely that most of the cattle marketed in February still lost money.

Packer margins average $63/hd during February

SUPPLY PICTURE

Packers seem to have recognized early on that the brutal winter has hindered cattle performance and they scaled their slaughter plans back in February to accommodate this reality. Fed cattle kills averaged about 465,000 head per week during February, about 10,000 head below what we were forecasting. By not pushing the kill too hard, packers were able to keep cattle price increases under control and boost beef prices at the same time. Our slaughter models project that kills could be slightly smaller during March, perhaps down around 460,000 head per week. There is more brutal cold coming to the northern-tier states in the next couple of weeks and that could limit cattle weight gains further and make it necessary to keep cattle on feed for longer than originally anticipated. Thus, there is a risk that actual slaughter falls short of our projection in March like it did in February, and cattle prices could exceed our forecast.

USDA recently managed to get caught up on the carcass weight data that had been missing due to the government shutdown during January. The most recent data shows steer carcass weights about four pounds below the same week last year and heifer carcass weights about 11 pounds less than last year. Carcass weight data is a very good way to measure the currentness of feedyards. However, there are two problems with simply looking at the raw reported carcass weights. First, there is a long-run upward trend in carcass weights through the years as both cattle genetics and feeding efficiency improves. Second, carcass weights are highly seasonal and generally lowest in April and heaviest in late October. In order to make the carcass weight data more useful for gauging feedyard currentness, we *de-trend* and *de-seasonalize* the carcass weights so that what remains is the irregular component. If this residual is zero then carcass weights are perfectly aligned with the long-run trend and the normal seasonal pattern. Values less than zero indicate that carcass weights are less than what the trend and season would suggest and indicate that cattle coming out of feedyards are weighing less than they "should", which implies that feedyards are relatively current on their marketings. Values greater than zero suggest feedyards are not current and a backlog of cattle is building. **Figure 1** shows the de-trended and de-seasonalized (DTDS) steer weights over the past few years. Currently, the DTDS weights are at -15, which is a pretty solid indicator that feedyards remain current and no backlog is building. Carcass weights normally take a long time to recover from a tough winter and thus we expect these DTDS weights to remain below zero for the next several months. This will provide cattle feeders with bargaining power and could keep upward pressure on both cattle and beef prices.

In addition, cattle feeders have not been very aggressive at restocking feedyards recently. The most recent Cattle on Feed report showed placements into feedyards during December were down about 2% and we expect that the next report (on March 8) will show January placements down about 6%. If those estimates are correct, then feedyard inventories will be less than one percent above last year. This points to tight cattle supplies right into summer. Buyers are advised to prepare for beef pricing this spring and early summer well above what we saw in 2018.

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DEMAND SITUATION

Each month, we have written about strong domestic demand for beef. Nothing has really changed in that respect. **Figure 2** shows the calculated domestic demand index by month for the last few years and our demand forecasts for 2019. It is clear that demand was very strong in January and although it pulled back some in February, it is projected to rebound heading into spring. We currently have dialed in some very strong demand for the second half of 2019, but there is risk to that forecast. Many of the macroeconomic indicators are pointing to economic slowdowns outside of the United States. The European Union (EU) economy is slowing, as are many of the Asian-Pacific economies. China, in particular, is slowing dramatically and could be headed for a recession. Because the global economy is so intertwined, these economic woes in other parts of the world will very likely cause slower growth in the US as well. If it does occur, it will likely come in the second half of 2019 or early 2020 and we may have to lower our beef demand projections in those periods.

Figure 1: Detrended & Deseasonlized Steer Carcass Weights

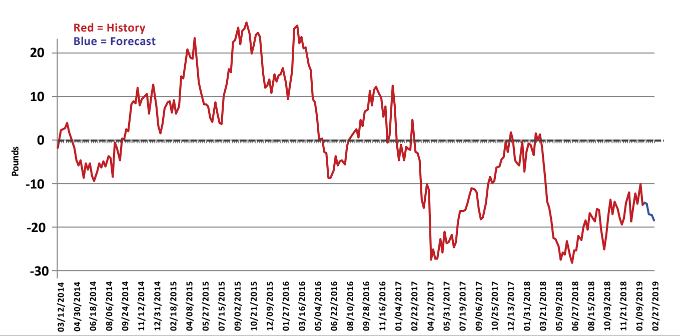


Figure 2: JSF Demand Index, Choice Cutout

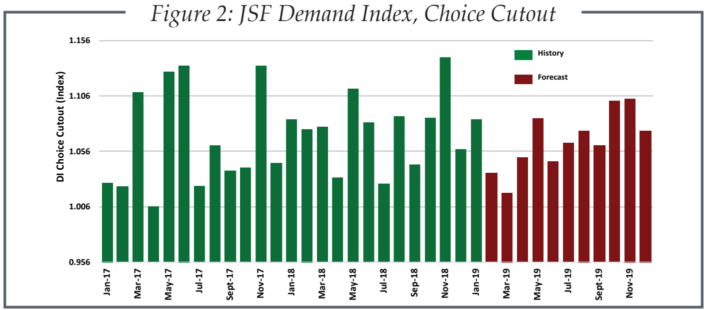


Table 1: JSF Cattle and Beef Price Forecasts

	13-Mar	20-Mar	27-Mar	3-Apr	10-Apr	17-Apr
Choice Cutout	221.5	223.9	226.6	225.9	226.5	228.3
Select Cutout	216.7	219.3	221.6	219.3	219.3	220.4
Choice Rib Primal	375.4	380.4	386.0	389.4	395.7	399.9
Choice Chuck Primal	177.1	179.2	180.1	178.9	177.5	177.1
Choice Round Primal	176.4	174.7	174.7	174.3	173.8	172.5
Choice Loin Primal	302.5	308.4	315.4	312.5	314.6	322.0
Choice Brisket Primal	190.5	191.1	193.1	194.8	192.5	191.0
Cash Cattle	129.7	131.0	132.2	131.1	130.5	130.7

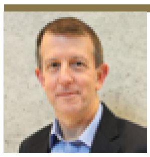
The US exports about 10% of the beef it produces, so macroeconomic slowdowns within the importing countries could very well curtail US beef exports. USDA has been slow to get caught up on its reporting of export movement, but our sense is that it has declined modestly, particularly to Japan and South Korea, two of the largest destinations. Beef that doesn't get exported must be consumed in the domestic market and the only way we can encourage consumers to take that extra beef is through lower prices. We will be watching the beef export data for signs of a slowdown. At present, it appears that the export business is relatively good, but that could change in the months ahead.

> Economic slowing outside of US poses **a threat to beef exports**

Another potential headwind for beef demand is super cheap pork. The pork cutout fell below $60 in late February and the spread between the beef cutouts and pork is near record-wide. Normally we would expect to see retail feature activity shift away from beef and towards the cheaper protein – pork, but that hasn't happened yet. At some point however, it will be difficult for retailers to ignore cheap pork and it may begin to displace beef in retail ads.

SUMMARY

Weekly beef production during March will likely be no larger than what we saw in February due to relatively tight numbers of cattle on feed and lighter-than-normal carcass weights due to harsh winter weather. Declining exports could expand beef availability slightly, but in general buyers will find beef supplies relatively snug. As the weather starts to warm and we move into spring, domestic beef demand should improve considerably as consumers look to get outdoors and grilling beef will be a favored activity. Tight supplies with seasonally-improving demand points toward higher pricing in March and probably even higher in April. Look for the cash cattle market to advance into the lower $130s and the Choice beef cutout to exceed $225 by the end of March. **Table 1** gives our weekly price forecasts for all of the major primals. Buyers should prepare for a strong pricing environment this spring.



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