VOLUME 1, ISSUE 2

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

THE MONTHLY

NOVEMBER 1, 2018

RED MEAT OUTLOOK: CATTLE & BEEF

Cash cattle in the US held steady for most of October at $111, but last week cattle feeders dug in and demanded higher money from packers. Trade took place at $114-115 and there is a reasonable chance that cash cattle prices will advance again next week. The recent gains in the cash market are the result of both supply and demand factors. On the supply side, cattle feeders did a good job of marketing their way through large numbers of cattle in early October and now available supplies are beginning to tighten up. There should be less cattle available for slaughter in November than in October and that supply could tighten even more in December. In addition, the Southern Plains received considerable rain during late September and early October, which resulted in muddy pens in many feedyards and that hindered cattle performance. That showed up in the carcass weight data last week as steer and heifer weights were down four pounds at a time of year when they normally increase. On the demand side, beef buyers were eager to book middle meats for the upcoming holiday season and packers were able to raise prices on those items and add to their forward sold position. That left packers in a position where they badly needed product and thus they were quick to bid the cash cattle market higher in an effort to secure the needed cattle.

> Average price levels in 2019 should be **below** this year's (2018) price

DOMESTIC BEEF SUPPLY

Currently, fed cattle kills are running close to 500,000 head per week, which is very similar to the same period last year. We lowered its fed cattle slaughter forecasts for the balance of 2018 and now has them about one-half percent less than Q4 of 2017. Non-fed slaughter, primarily cows and bulls, is a different story. Year-to-date, the non-fed kill is up 6-7% from last year. This is a sign that the industry is transitioning from a growing beef cattle herd to declining herd numbers. Producers have increased the rate at which they are liquidating breeding stock and it's a likely signal that the cattle herd is very near peak numbers and will soon move into a liquidation phase that could last from 5-10 years. **Figure 1** is a long-run look at the total US cattle population and the cycles of expansion and contraction are evident. The current cycle began when the inventory bottomed in 2014 and in the intervening years, about six million head have been added. We see the cycle peaking in 2019 and afterward cattle numbers are likely to decline for several years. The interesting thing about the last four cattle cycles is that the cycle peaks have been declining. A big reason for that is that carcass weights have been steadily increasing, making it possible to produce the same amount of beef with fewer animals. **Figure 2** shows the long run trend in fed steer carcass weights.
Just because the cattle cycle is topping doesn't mean that beef production will slow down. In fact, beef production should continue to grow for 2-3 years beyond the cycle peak. This is because producers will be actively liquidating breeding stock and retaining fewer heifers as herd replacements, and that generates more beef to be sold in the marketplace. So, if we take a long run view, average price levels in 2019 should be below this year and 2020 price levels should be even lower still.The most recent release of USDA's Cattle on Feed report showed that placements into feedyards were down 5% this September compared to last. That was the first decline since April of this year. Feedyards have been under financial pressure this year and by our calculation have been losing money on every animal marketed since February **(Figure 3)**. The economics are pretty straightforward. Feedyards paid way more for feeder cattle than they could recoup by selling finished cattle. The market is sending a strong signal to feedyard operators to either place fewer cattle on feed or substantially reduce what they are willing to pay for feeder cattle. With this latest report, we see that they have finally slowed down placements and we've also seen some deterioration in feeder cattle prices due to feedyards becoming less aggressive bidders. We expect this trend to continue and currently forecasts placement for Oct-Dec to be down about 4.6% from the year prior.

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Figure 1: January 1 US Cattle Inventory

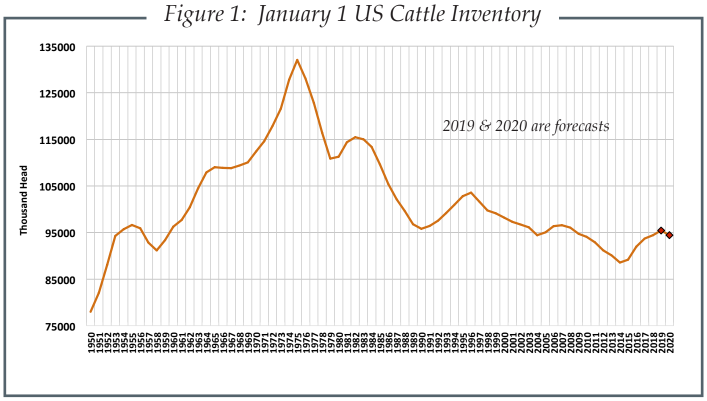


Figure 2: Steer Carcass Weights, Annual

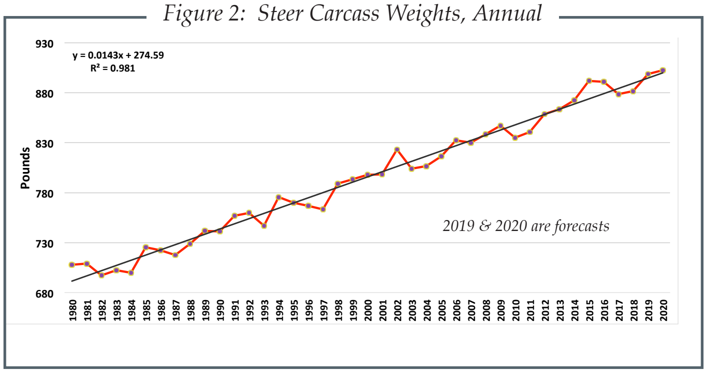


Figure 3: Estimated Cattle Feeding Margin

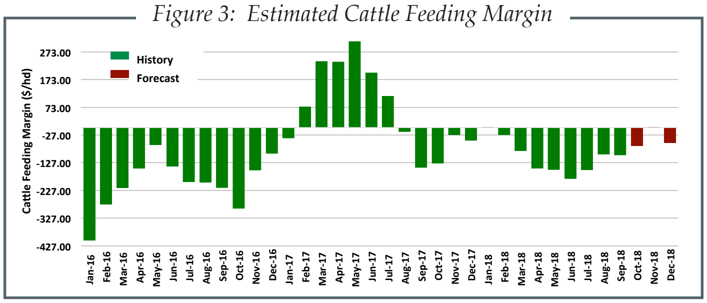


Table 1: JSF Cattle and Beef Price Forecasts

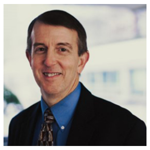
	7-Nov	14-Nov	21-Nov	28-Nov	5-Dec	12-Dec
Choice Cutout	214.5	215.5	214.6	214.3	213.6	210.3
Select Cutout	197.3	196.4	194.1	193.3	194.7	195.1
Choice Rib Primal	408.5	412.5	414.5	416.5	402.5	372.3
Choice Chuck Primal	172.3	173.0	171.5	170.5	171.0	170.3
Choice Round Primal	173.1	172.2	170.9	171.8	171.6	171.1
Choice Loin Primal	270.8	273.0	271.4	269.6	272.4	274.1
Choice Brisket Primal	177.2	176.0	175.5	176.0	179.0	180.6
Cash Cattle	121.0	122.4	122.2	122.5	122.8	121.9

DOMESTIC BEEF DEMAND

The current demand situation for US beef remains relatively strong, but there could be dark clouds on the horizon. The US stock market took a beating in October and it could have an impact on consumer confidence, including their propensity to spend on a high-priced protein such as beef. In the very near-term however, the focus is on celebrating the holiday season in style and beef will be an important component of that. Middle meat markets are trending higher as they normally do heading into the holidays and stronger-than-expected demand has caused us to raise our forecast for middle meat prices through December. The updated forecasts are provided in **Table 1**. We fully expect the market for ribeyes to exceed last year's Q4 top by a substantial margin. Buyers without coverage for the holidays are likely to face very firm pricing and may find that product is not available in some cases. End meat pricing also gained some traction in October, but the price increases there were more muted that what has transpired with the middles. Chucks and rounds are projected to trade mostly sideways through November and December before posting further gains in Q1. Middle meats, particularly ribeyes and tenderloins, will likely top in early December and then decline rapidly in the last few weeks of the year.

CONCLUSION

One of the most important things to watch at this time of year is the weather. Feedyards have already had to deal with above-average moisture levels in October and if the Plains States continue to get large doses of precipitation, either rain or snow, then there is the risk that feedyards will get even muddier and cattle performance will degrade further. This week's weather looks pretty good across cattle feeding country, so perhaps some drying will occur. However, November and December snow storms have been known to quickly hamper cattle weight gains and have led to sharp spikes in both cattle and beef prices. Buyers should monitor the weather in cattle feeding states for indications of excess precipitation in the next couple of months.



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