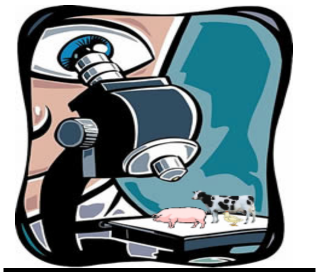
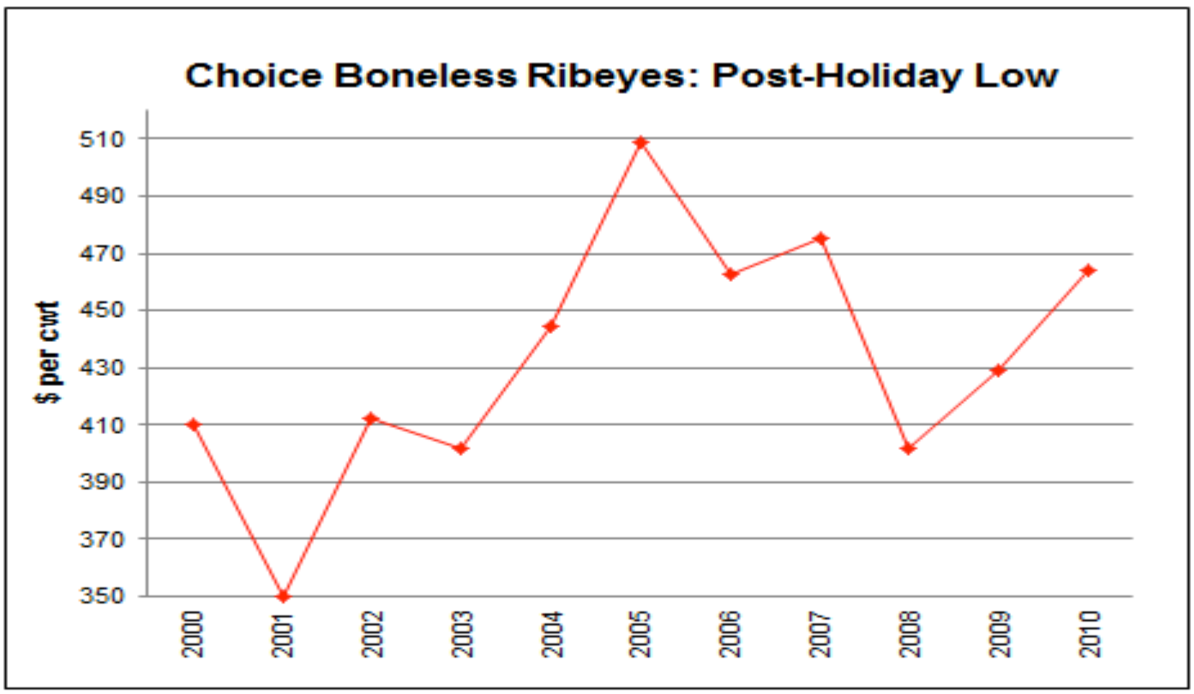


MEAT MARKETS

A perspective on the major proteins by Kevin Bost….sometimes wrong, usually scientific, but always candid

December 12, 2011

Judging from prices currently being offered for January delivery, it seems all the more likely that Choice boneless ribeyes are headed for the $5.25-$5.40 per pound range, with bone-in product aimed toward $4.75-$4.85. There is always some question of the degree of support that the "Wal-Mart Effect" will lend to the Choice market—not only in rib meat, but other cuts as well—but I'll remind you that even $5.25 would be the highest post-holiday bottom on record:



Major support on the chart lies most conspicuously at $5.00 per pound, and from this angle, that price seems within striking distance, doesn't it? The next question is when is the bottom most likely to occur? Well, I think we should consider the possibility that the stronger prices become in December, the more negative the impact on wholesale demand is likely to be in the "wake"…..implying, in English, that consumer-level prices are adjusted more starkly upward in the post-holiday period following a sharp run-up leading into Christmas, thus creating a bit more of a vacuum in wholesale demand. This may be pure coincidence, but I notice that in 2005/2006; in 2006/2007; and in 2007/2008, the years that have, up to this point, recorded the highest December average prices, the subsequent low occurred somewhat later in the spectrum. The following table shows the week in which the low was registered within the last 15 years:

The week in which the weekly average low was recorded is marked with an "X":

Year	Wk 1 Jan	Wk 2 Jan	Wk 3 Jan	Wk 4 Jan	Wk 5 Jan	Wk 1 Feb	Wk 2 Feb	Wk 3 Feb	Wk 4 Feb
1997							X		
1998				X					
1999				X			X		
2000							X		
2001		X							

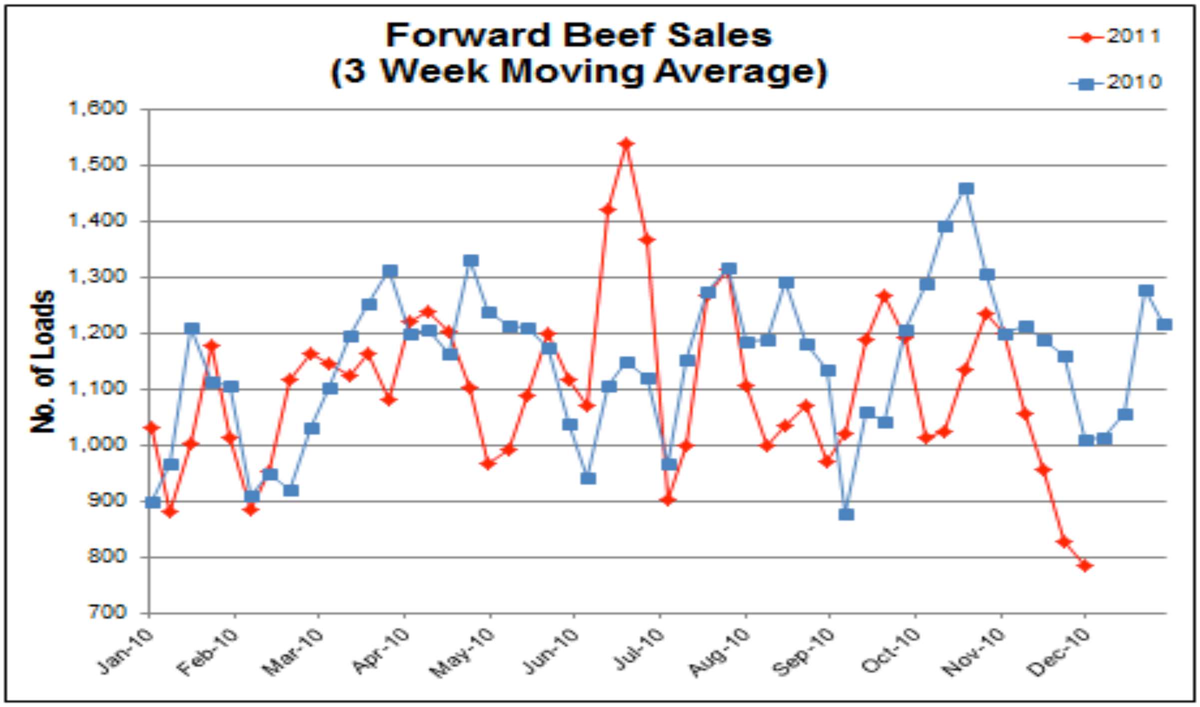
2002		X							
2003	X								
2004	X								
2005									X
2006							X		
2007					X				
2008				X					
2009								X	
2010	X								
2011	X								

If we can expect an ultimate bottom in late January or first-half February, then we should probably also expect some sort of temporary "bounce" in early January….the sort of thing that tests a buyer's patience. Anyway, the notion of a late January or early February low makes some sense within the current context.

As for Select-grade ribeyes, these have never really gotten off the ground. They have so far fallen short of the fourth-quarter highs of each of the previous eight years, while their Choice counterparts have achieved record levels. This is a situation with which I am quite familiar, as I witness my older brother and my counterparts in this business excel while I languish in obscurity. [I have no idea what my brother does for a living, but whatever it is, it seems vastly more important and successful.] I can personally relate, then, to the condition of the Select ribeye…..but I shall surely save this analogy for my therapist and no one else. The nearest support level in the market for Select boneless ribeyes stands at the October 20 low of $4.36; and even though this price is above last year's post-holiday low of $3.96, it is not all that far from the obvious support level of $4.00 per pound. At this time of year one is compelled to give the benefit of the doubt to the downside, yet the potential is not great. I suspect that in general, I am not the only guy in this world who takes notice of the extraordinarily wide spread between the cost of Choice and Select ribeyes in the wholesale market. Actions among both supermarket and foodservice operators are taken accordingly…..

The discussion of rib meat relates directly to one of the more significant developments of the past week, that being the decline in the combined Choice/Select cutout value below $180 per cwt, which I had regarded as significant support. The major boundaries of the combined cutout are now at $176 and $190, which is a downward adjustment from my previously-held expectation…..and which causes me to downwardly adjust my sights for first quarter prices. What's happening here is becoming evident—that demand for beef at the wholesale level (after seasonal adjustment) is dropping materially here in December as compared with the lofty November reading. Why should this not make sense? Forward booking volumes have been tepid indeed, as the three-week average now stands at its lowest level in at least two years (I didn't bother to look farther backward—the point is made). Apparently, wholesale prices have risen high enough to have adversely affected sales volumes into both domestic and export channels. By the way, the decline in the seasonally adjusted, wholesale beef demand index from November to December looks like it will be the third-greatest of the past 20 years (only 2003 and 2008 will have been greater).

The timing is "right" for a cyclical low in the cutout value to occur this week, this being the third week of cyclical decline (which matches the most common period of short-term "down" phases of the past twelve months). But the prospects of a "V-Bottom", and a smart, upward launch from this bottom are unlikely…..and this is where the rib meat discussion comes into play. If Choice ribeyes meet the downside targets as described above, then the Choice cutout value will lose roughly $6.50 per cwt from the rib market alone; in the absence of any decline in Select rib prices, the negative impact on the combined cutout would amount to $3.50. It will take a substantial increase in prices of other cuts—presumably end meats and grinds—to make up the difference.



And so the discussion turns to the subject of end meats and grinds. Addressing firstly the grinds, I have to believe that a typical price increase is in the offing between now and a late-January peak. What is typical? The price increase in 81% lean ground beef and ground chuck between the second week of December and the fourth week of January has ranged from 23% to 46% in the last five years; such an increase this time around would carry 81% lean coarse grind quotes to anywhere between $2.08 and $2.47 by the end of January. In the ten years prior to that, the increase averaged 13%, which would measure to $1.91 at the end of January 2012…..quite a range, I realize, but the point is that I would be shocked if ground beef prices did not go up sharply over the next six weeks. Last year's peak in 81% lean ground beef quotes was $2.08 on February 1. The market has a "head start", so to speak, in that last week's weighted average quote of $1.69 was 30¢ per pound above the same week a year ago. Consumer-level ground beef prices are surely significantly higher than at this time last year, and that is generally not conducive to accelerated volume through the "pipeline". However, it makes sense to me that ground beef, being the lowest-priced of all major beef products, and being the target of many casual and upscale dining establishments, will continue to garner a greater share of the total wholesale beef market.

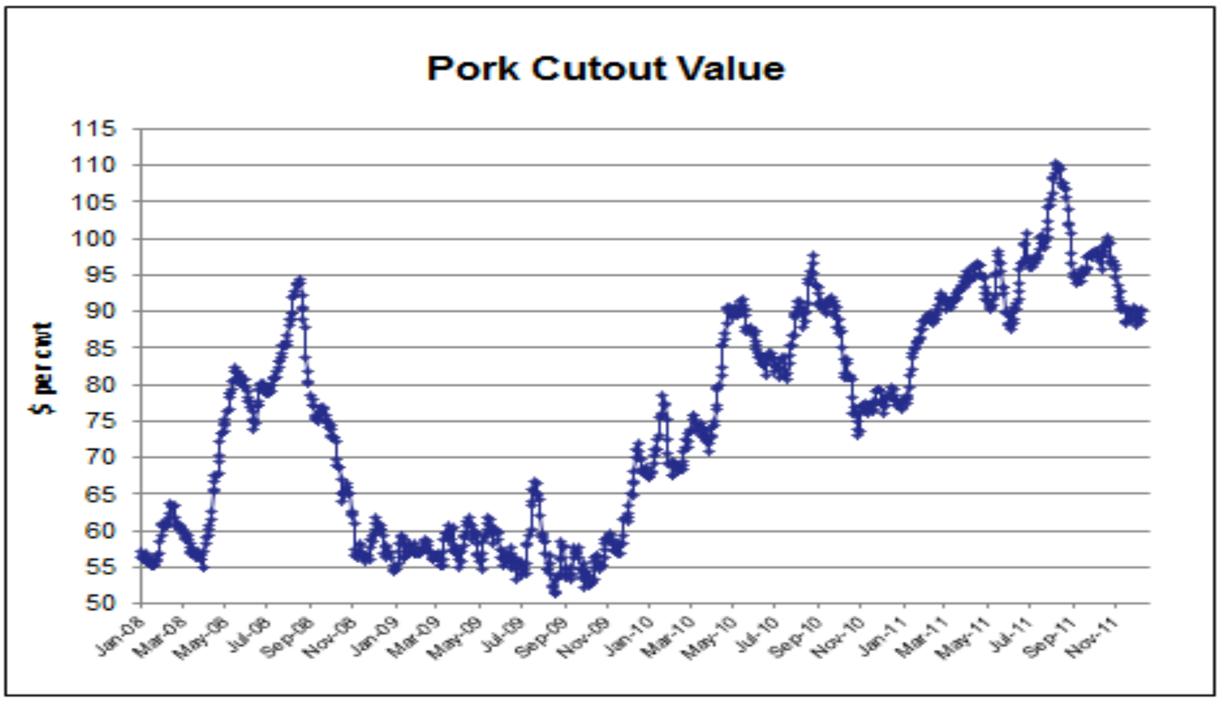
As for the chucks and rounds, first I notice that the bottom round flat has broken down more extensively than any other cut within this "family". The flat was quoted at $2.06 per pound on Friday, and its chart displays no support above $1.80-$1.90; I have to give this market a chance to decline another 15¢ per pound, then, although—although—it would be quite unusual for flats to decline in value between now an Christmas. This has happened only once since 1998. Chuck rolls, meanwhile, are within 10¢ of their support level of $2.10; knuckles are within 5-10¢ of support; shoulder clods and inside rounds equally close. I would guess that whatever downside potential remains in the chuck and round cuts will be realized within the next week or so.

What we should think about is this: will retail prices be elevated enough to discourage product movement of chuck and round cuts in January? I have introduced this possibility repeatedly within the last few months, and repeatedly it has been refuted; but at *some* point, encountering basically flat consumer spending power, higher retail prices have *some* impact on product movement. We might be encountering a period of reckoning, so to speak…..temporary though it may be.

Finally, it seems likely that fed cattle slaughter will be subdued through the balance of December and even beyond. Steer and heifer slaughter made a temporary recovery to 508,000 in the week after Thanksgiving, but fell to 494,000 last week and in my estimation will fall further to 480,000-490,000 in the final non-holiday weeks of the year, and then to an average of only 490,000 per week in the non-holiday weeks of January. The production side of the equation, then, will yield no further, meaningful downside relief in beef prices. Why would it? My smarter sources tell me quite clearly that available cattle supplies will increase in January and February, yet the fact remains that packer margins are extraordinarily poor.

Packer will most definitely regain control over their spot margins, and they will do so by reducing production schedules relative to available cattle supplies. This development is, I think, coming in January.

The pork cutout value has reached a critical juncture. It has now spent four weeks within a tight range of (essentially) $88.00-$90.50; whenever a market consolidates for a period of time, it must indicate a temporary state of equilibrium, and so a move outside of that range indicates a change in the supply/demand balance; the more protracted the period of consolidation, the more significant the subsequent breakout. Four weeks constitutes a protracted period of consolidation in the pork cutout value. And so here is the simple assessment: if the pork cutout value drops below $87.50, it will point toward a substantial move to the downside (the next major support level is $80); if it pushes above $91.00, then a major move to the upside is indicated—and the nearest major resistance level is near $100.00. Obviously, then, a pronounced move in one direction or the other is "on deck". Now, how is *that* for "wishy-washiness"? It is the one thing I try to avoid when I write this letter, yet I must be honest that as a trader of both meat and futures, I have learned that it is far more important to recognize the changes in trends early in the game, and to take action accordingly, than to have been proven right via the initial forecast. And so as a trader, I will follow the market in whichever direction it chooses to break out.

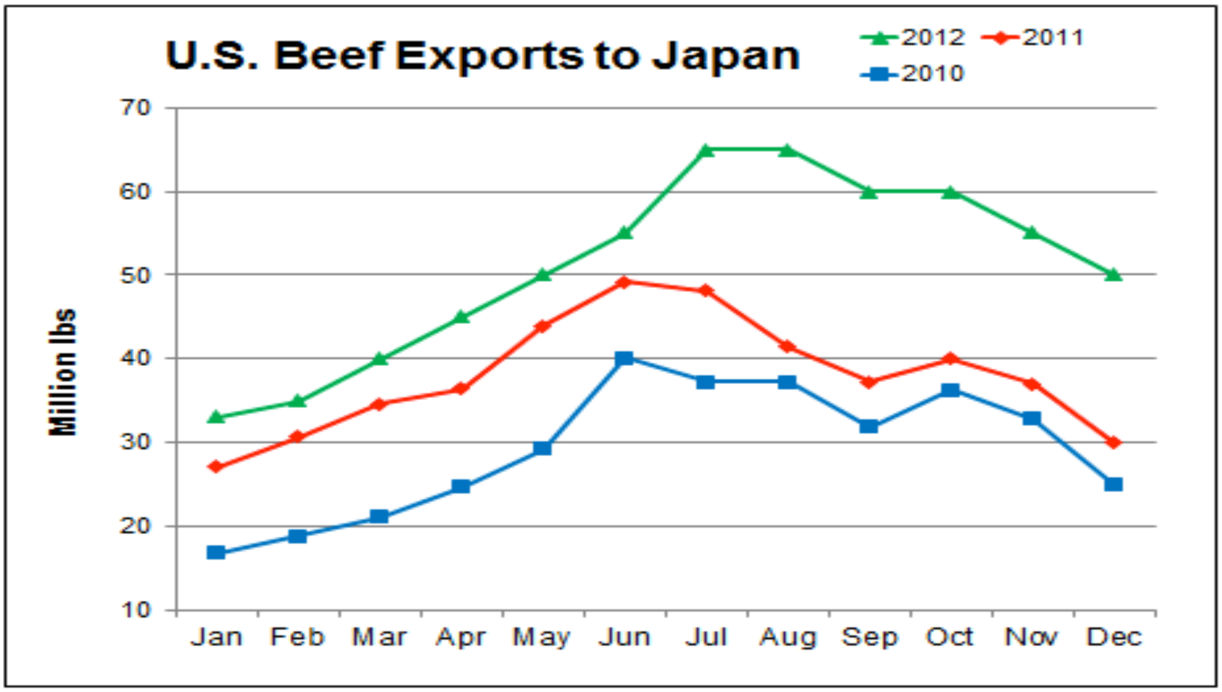


Within this context, I must say that a steady composite wholesale pork market over the next three weeks, followed by a move upward, is the most likely scenario. The upside potential in the loin market between now and the end of the month appears to approximately match the downside potential in ham prices, each being about 15¢ per pound. That would carry bone-in loins to $1.35, and ham prices to $.73-$.75….assuming that nothing else among major pork products changes materially, which I can accept as a likely scenario. Neither pork trimmings nor boneless picnics nor pork butts show a discernible tendency toward anything but steady price behavior over the next three weeks, and there appears nothing on the supply-side horizon that would create anything other than typical price behavior; in these final two weeks prior to the holidays, hog slaughter should be near 2,320,000 in the week ahead and 2,385,000 in the normally-inflated week prior to Christmas. Hog supplies will then drop in January, to an average of 2,185,000. This sort of picture would be a fairly normal supply pattern; and it would lend itself to firmer prices for bellies, trimmings, and boneless picnics after the first of the year; and some recovery in ham prices accompanied by some setback in loins and butts. This, I think, is what the future holds.

But as a precaution: if the pork cutout value *does* drop below $87.50, then a pronounced round of weakness will be clearly indicated; and in that case, some surprisingly weak wholesale pork prices will surface in January. And in that case, *caveat emptor* becomes the rule…….

As a final note, the most solid confirmation yet that Japan honestly intends to relax the age restriction on U.S. beef surfaced Friday, as the Kyodo news service reported that an important endorsement of the idea was delivered from the Agriculture Ministry's food safety body. Specifically, Japan will begin to accept beef from U.S. and Canadian cattle up to 30 months of age. This is the practical equivalent of no age restriction at all, in that the supply of North American beef eligible for export to Japan will be dramatically expanded. The market impact should be most pronounced in the September-through-March semester, during which the supply of finished cattle 20 months of age and younger are most restricted. As for exactly when the "door will be opened", I won't pretend to know. My guess is sometime between April 1 and July 1. Although this is a politically sensitive issue in Japan, I wonder how much debate actually remains following this endorsement. The opposition viewpoint is practically out of ammunition, as the worldwide number of cases of BSE reported so far this year, according to the World Organization for Animal Health, has so far numbered only 13 cases in 2011, compared with 2,215 ten years ago. The most recent confirmation in the U.S. occurred in 2006.

My humble guess is that U.S. beef exports to Japan, which are already pretty healthy, will expand thusly:



A 50% increase in trade volume to Japan in the second half of 2012 sounds excessive, but we're talking about a monthly rate of 50-65 million pounds per month; they reached a peak this year in June, at 50 million pounds. Under the circumstances, is this overly optimistic? Prior to the first discovery of BSE in a U.S. cattle herd, monthly exports of beef to Japan averaged 77 million pounds in 2003; 64 million pounds in 2002; and 84 million pounds in 2001.