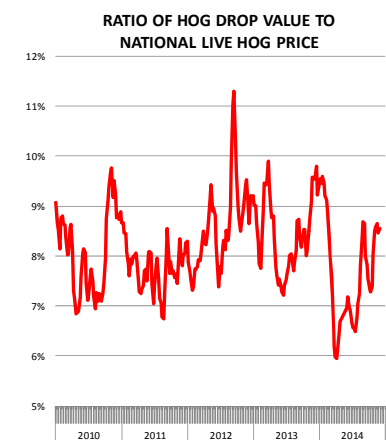
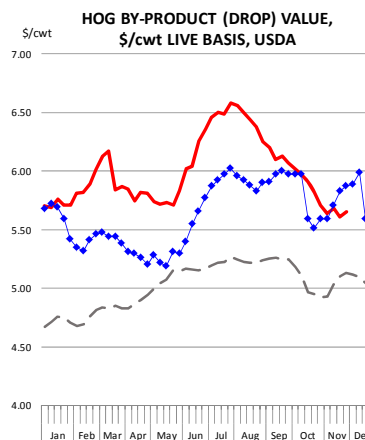
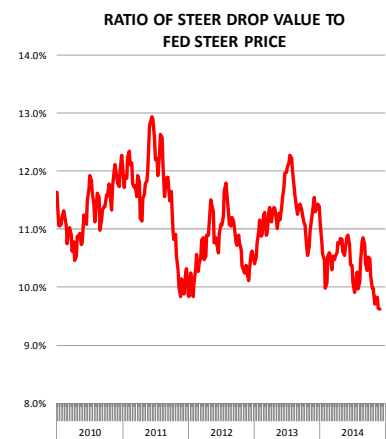
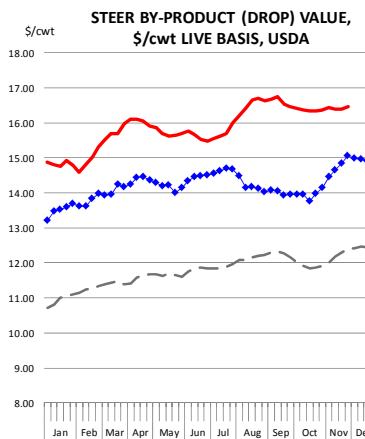


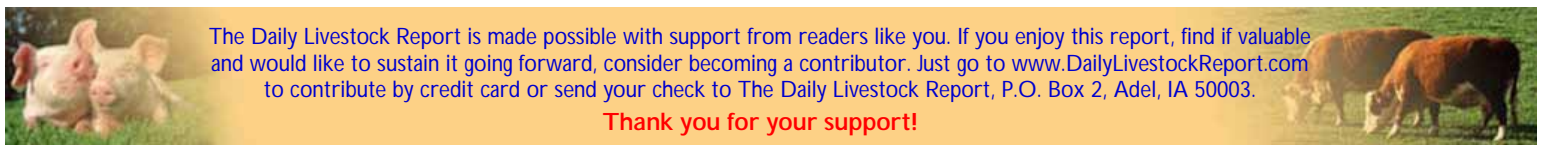
By product values account for a significant portion of the overall value of the live animal but they often do not get as much attention as some individual cuts. This could be in part because it is easier to understand the rise in price of bacon or steaks than what is going on with leather prices or the price of offal items. But in the case of cattle the drop value accounts for about 10% of the value (a bit less for hogs) and thus price moves for this items will tend to impact overall fed values in the cash market.

Steer drop values currently are holding near all time record levels on sharp declines in fed cattle slaughter and record fed cattle prices. The steer drop value for the week ending November 28 was \$16.46/cwt (live basis), 9.3% higher than a year ago and 32.7% higher than the five year average. Leather accounts for almost half of the steer drop value and leather prices are now near all time record highs. But leather prices have been drifting lower after hitting a record high of \$116.25 per hide in early September. Normally hide prices are higher going into winter, in part because of the decline in cattle slaughter. The challenge with leather is that even as demand for luxury goods has improved, end users have the option of switching to less expensive raw material if the price gets too high. A report from the Livestock Marketing Center made that point as they noted: "industry sources are reporting high priced hides are causing some leather users to switch to less expensive lower grades of leather, canvas, and synthetic leather-like products. Some have even suggested changes in luxury women's boots toward shorter (ankle high) styles in part due to higher wholesale leather costs." Other by-product values also have failed to keep up with the sharp rise in fed cattle prices. For instance, tongue prices which are greatly dependent on export demand, have been flat for much of the year and currently are under year ago levels. As a result, even as we continue to see near record drop credits, the ratio of the drop credit to live cattle values has been steadily declining and currently is under 10%. It was over 12% in mid 2013 (see chart) and near 13% in 2011. The fact that drop credits are not keeping up with cattle values is, in our mind, negative for cattle prices going forward. It means that other cuts will have to carry a larger portion of the value going forward. So far, higher chuck and round cut prices have provided the bulk of the support. The worry among market participants, and what is playing out in the futures this week, is **whether high chuck and round cut values will be sustained in the coming months given increased competition from cheaper proteins at retail and changes in portion size and product development at foodservice.** There are certainly bullish arguments that can be made for cattle in 2015 but the trend in by-product values is not one of them.

Hog drop values also have been trending lower in recent weeks after hitting all time record highs in the summer of 2014. Seasonally the hog drop credit is higher in the summer as hog slaughter declines. Recently, however, drop credit values have declined below year ago levels, weighing on overall live hog prices. The data for week ending November 28 showed the hog drop credit was \$5.65/cwt (live basis). Different from cattle, where



the hide accounts for such a large portion of the value, in hogs the drop credit depends on a number of items. Pork blood meal is about a quarter of the value with lard also accounting for 11% and cheek meat accounting for 6% of the value. In the case of lard, lower prices for fats overall (bean oil remains depressed) have been negative for the market. Also, lower protein meal prices (compared to summer levels) also have affected the credit. More broadly speaking, however, the down trend in hog by-product values reflects the much improved supply conditions. Weak exports also have negatively impacted this market. The panic in the hog market has subsided with more hogs expected to be available in the coming months, thanks to a decline in PEDv cases. Today, the ratio of the hog drop credit to the live hog value currently is in line with historical levels, an indication of stability in the hog complex.



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