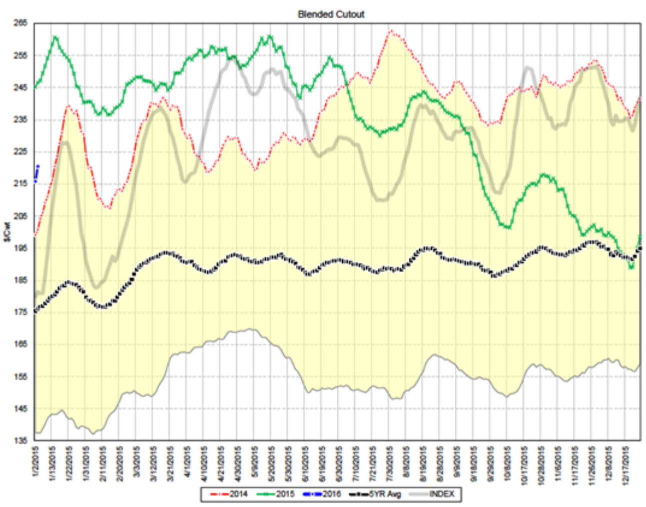
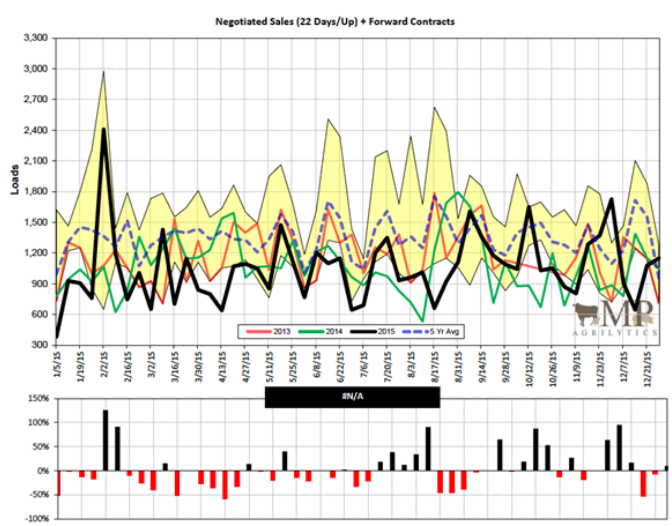
December 2015 Monthly Commentary

December was yet another violent time for the cattle market. The market broke roughly $10 to start the month only to end up $15 off those lows and +$5 by the end of the month. Trade had little to no hope for the future as feeders chose to liquidate their remaining inventory during and ahead of several winter storms that hit the north as well as the south feeding areas. This resulted in cash live cattle prices falling from $127 to $115. This final puke from the country has officially cleaned up the carry from the summer supplies and leaves the market with less supply as we look to the first half of 2016. As a result of this liquidation in inventory, the USDA Cattle On Feed data has come off its summer peak from 103% of a year ago to now being 99% (at best). Weights are also a changing market factor. Weights had been running 25-30 lbs. over a year ago through the summer and fall. However, today weights are very close to a year ago now and expected to continue declining into early April. This has been one of the harshest winters in some time as a very wet fall was followed by a warmer than expected beginning to the winter making winter feeding conditions muddy, wet, and stressful on the animals' production abilities. Cash has since rebounded to $135 in the past few weeks. Outside of a minor seasonal correction in late January or early February, prices are expected to continue higher into the spring and summer.



As we start the New Year, the cattle market finds itself on the heels of yet another sharp rally off its lows. In our last discussions we said that the market didn't deserve to be into new lows based off its fundamental supply outlook. That was when futures prices were at $130. But because of the desires of many to sell off their inventory prices, new lows were made in mid-December—futures were as low as $122 ($190 beef). As a result of this decline in prices retailers were able to acquire stocks at a large discount. This forward purchasing action has created retail ad features as well as lower prices for the month of January. For example: steak cuts through the fall were $12/lbs. and today they are $6.99 while ground beef prices were $5.99 and today they are $2.99. This is creating demand and moving meat. Packers have been responding to this renewed demand by increasing their demand for live supplies and raising beef prices in hopes that demand will continue. The true test of demand increases will be when we can increase the slaughter pace and prices are steady or even able to move higher. Beef prices today are $228 (or $144) and $38 off their bottom, this compares to last weeks live trade that was $135, therefore replacement margins are still positive. The pricing issue that futures will struggle with is that the bear market in 2015 was dominated by poor demand and more supplies. Many people will still say demand is poor, supplies are still growing, and sell rallies. However, clearly all of these things have changed since December 15th. As demand grows into a smaller first half supply situation prices should continue to trend higher.



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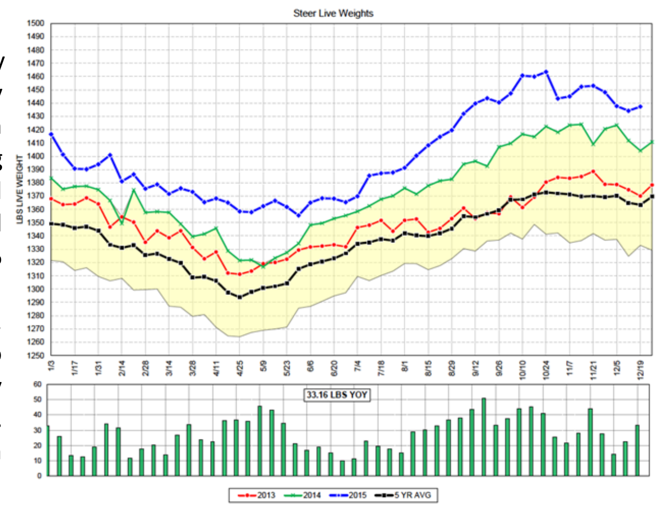
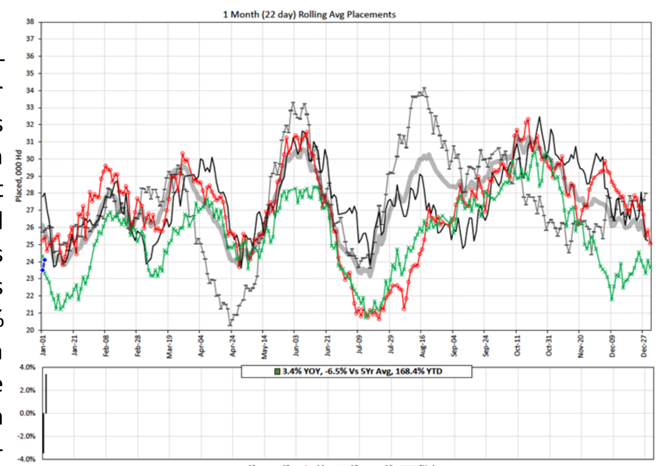
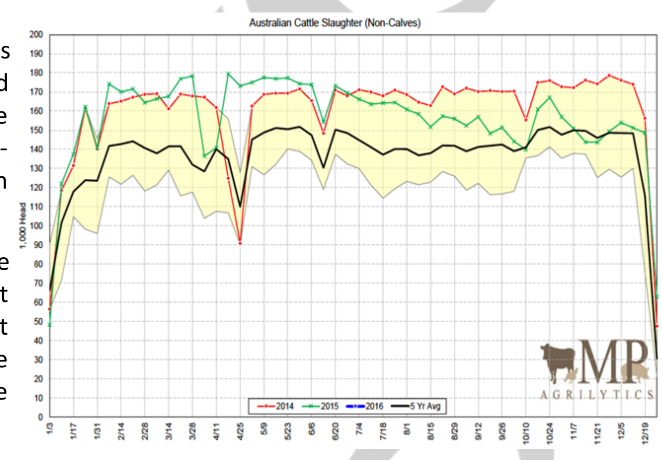


Weights are something we need to continue to monitor as they were an anvil tied to the market's leg all throughout 2015 and only since December have we seen them come down. Weather has been the issue as well as the liquidation in the front-end supply took the big cattle off the market from the north. Because of weather, weights will continue to trend lower into April. This is a larger affect on price and supply than most forecast. This 25 lbs. average affect is like taking 3% away from the supply alone and recognize that this reduction has been as much as 50 lbs. in areas that were hard hit with rains in the north. This can push cattle out at least a month if not two as compared to original placement expectations. So December cattle become February and February's become April's and Aprils become June's as an example. Not only was there much less placed but they were pushed out from weather as well.



Placement patterns have been down for months now. Heavy realized loses at harvest this fall for the feedyard, and recent bad weather has continued this trend into December. There is a chance the USDA is currently overstating the current supplies given what we have seen from individual state associations as compared to USDA's most recent data. November's placement pattern was the smallest ever on record at -11% from a record small number from 2014 while state associations were more like -20%. The USDA is expected to post Cattle On Feed as of January 1st at 99% with Marketing's at +102% and Placements -5% on January 22nd. Since placements have been down four months in a row, supplies will continue to be tighter than expected well into the spring and early summer. Placements will be bigger than a year ago in January but keep in mind this compares to an all time record low placement rate in 2015. A 10% increase will still be an incredibly small number, and these should be July or August cattle and in some cases September cattle.



The board has been carrying a wide premium to cash for months and now things have become normal. Basis was -$12 a month ago and is now only par. The board is expected to be premium to cash until we move into the early part of the spring. This is a good thing for us fundamental traders as there should be a more direct relationship with cash and futures as we look forward.

I know I sound like a broken record but the true impact in the wake of a multi-year liquidation affect in Australia will continue to affect world supply. We have seen the beginning of this impact in the recent months and we will continue to see smaller and smaller supplies as we look into 2016. This should lead to less imports into the US and more export demand from Asia for the US.

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Options volatility has come back down to earth after posting upwards of 30% in October and November. Options are something we have come to rely on to help us manage risk but during this spike in volatility we were forced away from them. Today volatility is more like 17%. By comparison this change in options volatility amounted to roughly $3.00 in options prices all things considered. This is a good thing for our strategies and focus as we can now re-engage this part of the market as part of our positions.

The CFTC Commitment of traders report continues to show a very large commercial long position. However, one thing that we have seen in this rally off the lows that we did not see in the last rally is that before commercial positions dropped slightly and this time it's growing. The only sellers we have seen on this rally came from the speculative longs.

The risk to our outlook is the Chinese economy and/or a collapse in the US stock market. Outside markets can be very disruptive to the trade and flow of HFTs these days and their ability to trade headlines and control trade temporarily. However, over time as we have seen with this rally in December cash is king and should continue to have a strong foot hold on prices and trade for 2016.

We were only able to recover a third of our drawdown from November as the $4 to $5 rally in December compared to the $10 to $12 break that we were also long for in November. We had expected this recent $20 rally in cash prices to start from $125 vs $115 like they did. We still think moving toward that $150 is likely this spring and maybe even later this winter. We are expecting prices to potentially decline into early February but overall we view that risk is still to the upside and as a result we remain bullish into the spring and summer and will look to be longer on breaks. Weekly supply availability seems very similar to that of this past summer when futures prices were $150+ as well as this past October when futures prices were $143. There is no reason why that shouldn't be true today. Futures are clearly discounting further price advances. As the exposure grows we will likely engage in buying puts against the fall contracts as a hedge against risk. This should allow us to play the weather market that is affecting weights and help manage risk if we are incorrect in our positions overall or on timing.

Regards,

Scott Shepard

1/07/2016

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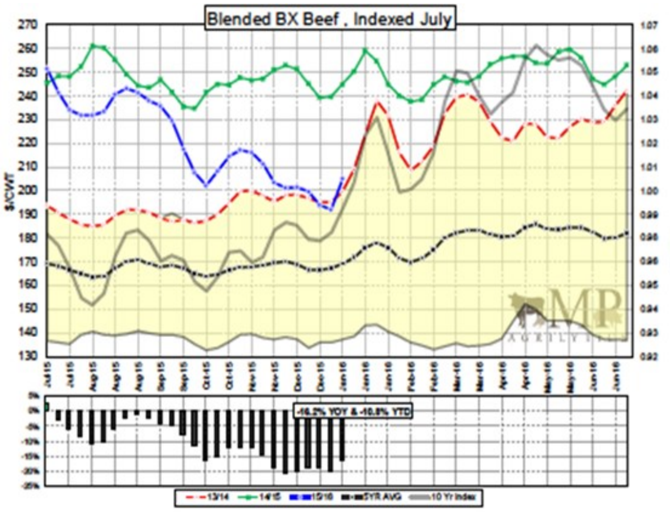

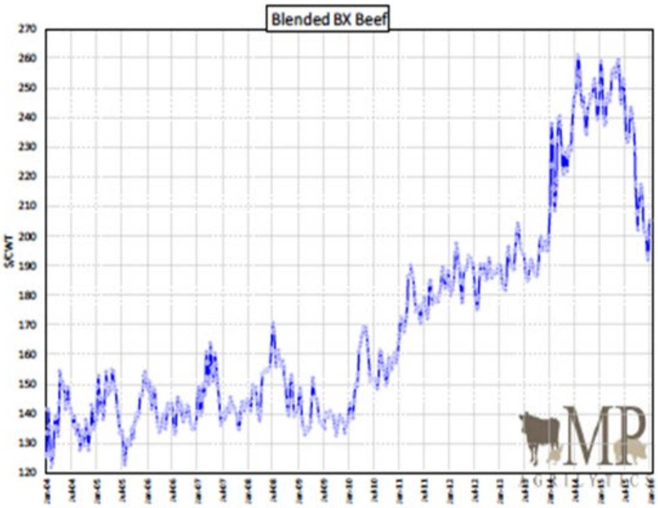

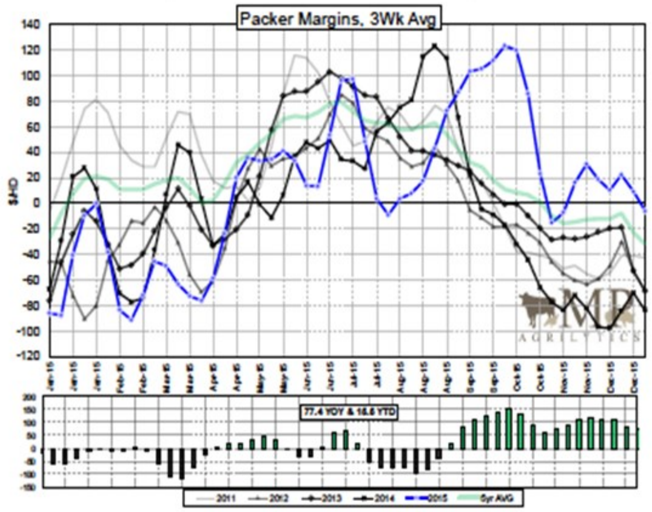

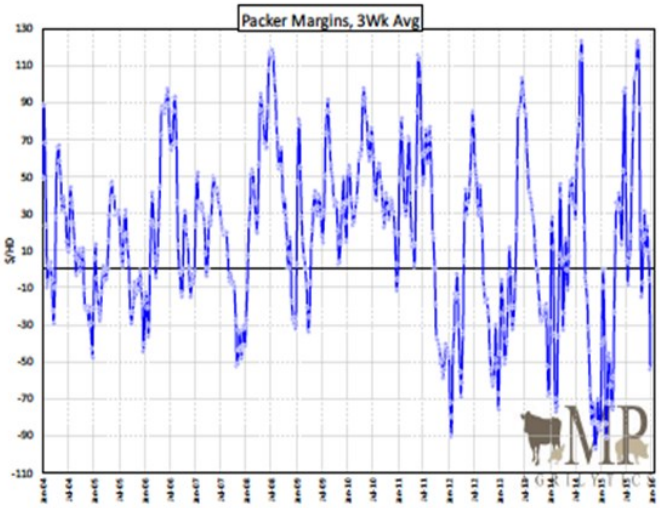

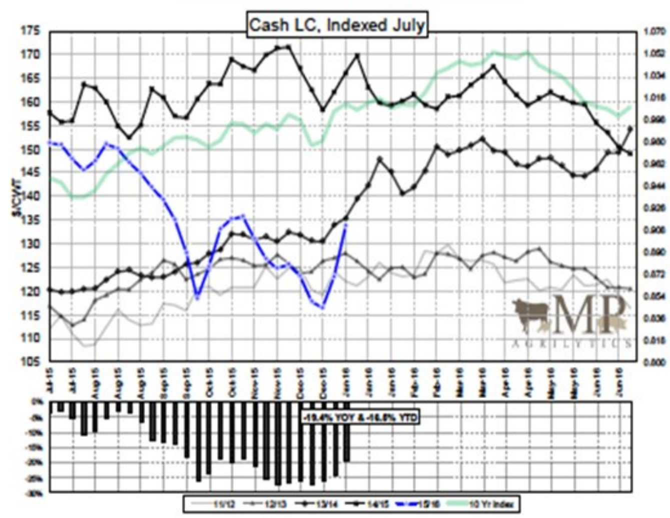

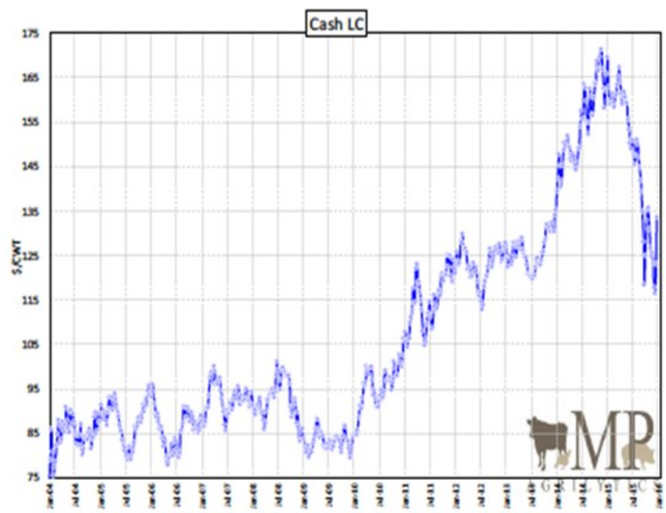

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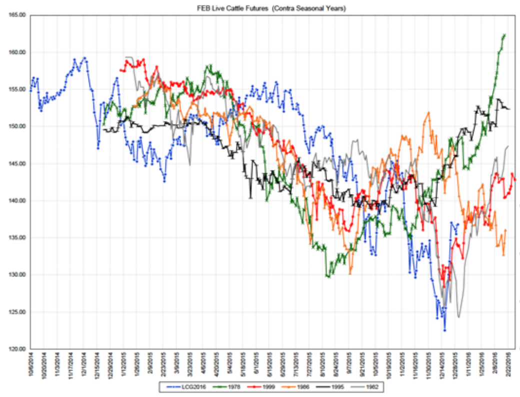

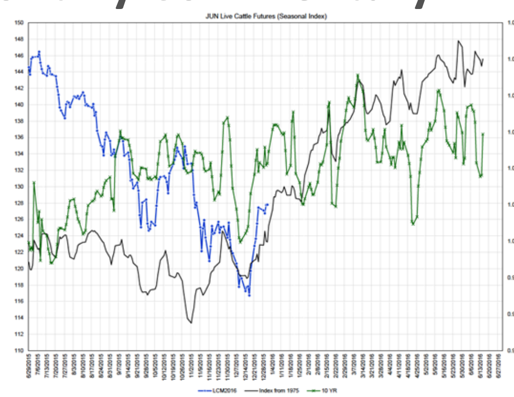

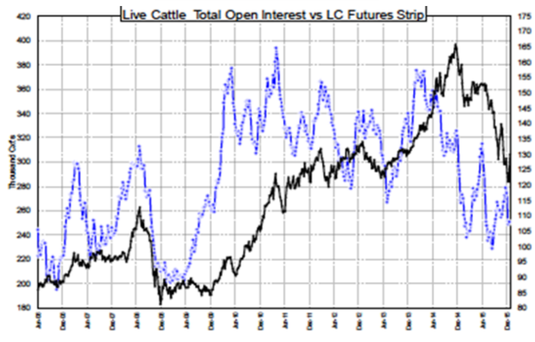

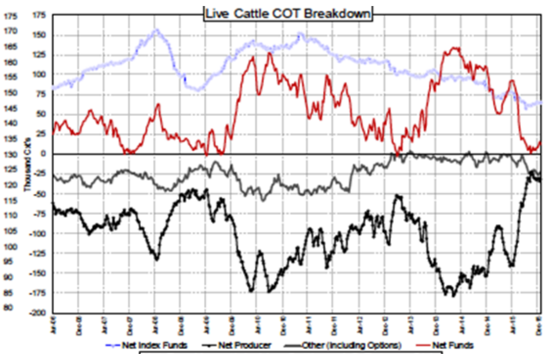

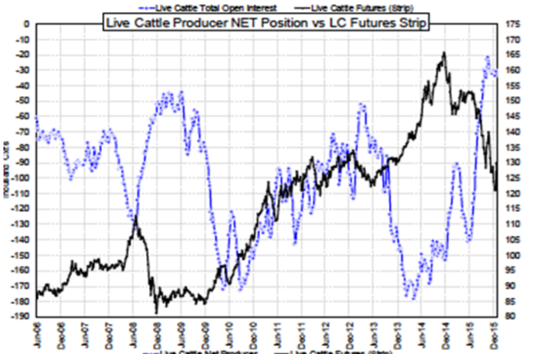

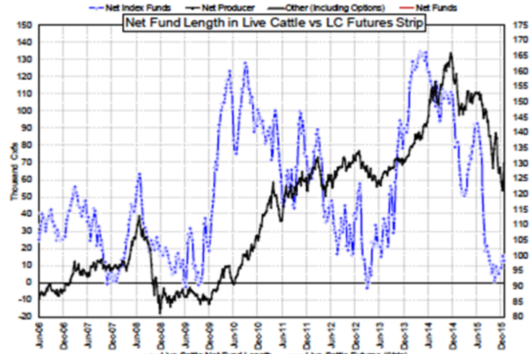

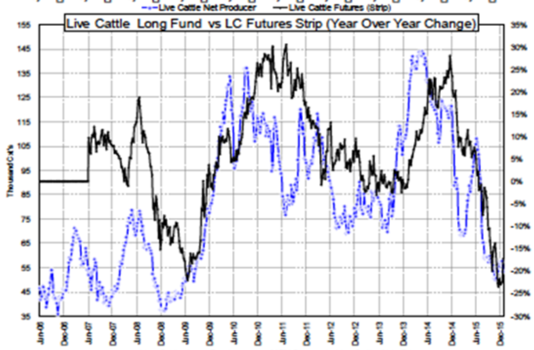

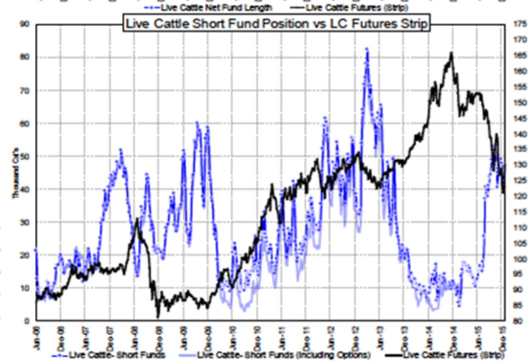

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