

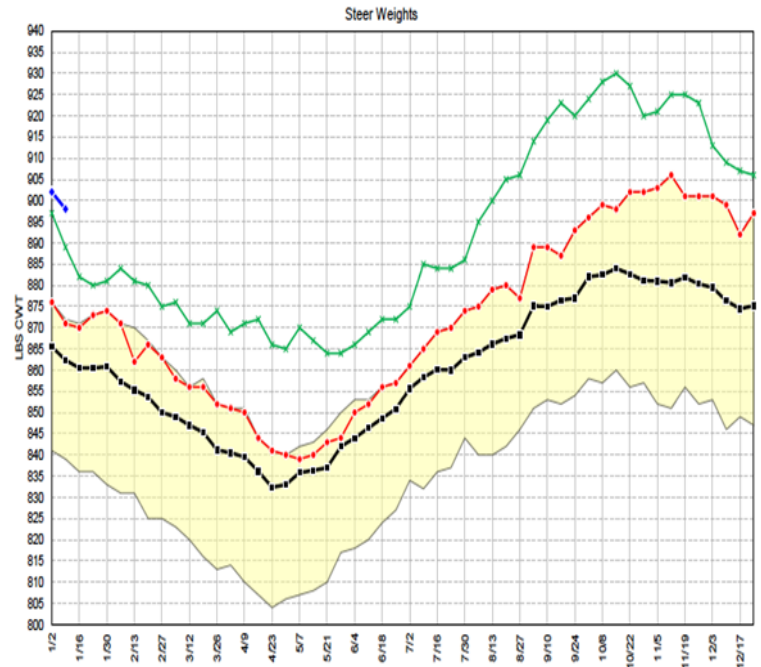
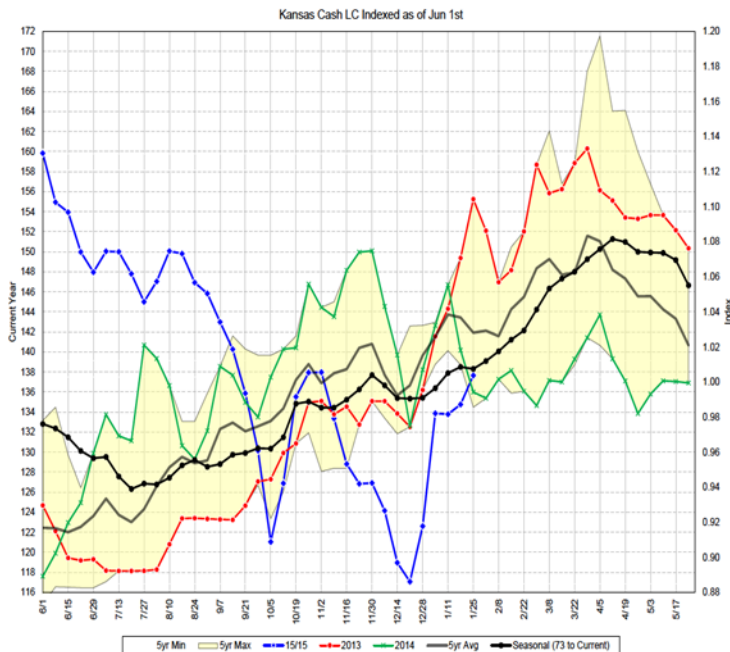


## January 2016 Monthly Commentary

January was yet another violent time for the cattle market. Outside market influences pulled futures down flipping the board from a \$4 premium to cash into a \$4 discount to cash. All the while cash remained more or less steady at \$134 before surging at month end to \$138. This larger than expected correction in futures forced us to stop out of positions before we could get them to really work. We maintained more risk adverse positions into the end of the month that allowed us to remain focused on our bullish bias into the spring. Timing is the most important aspect of trading; being right in the end but too early is still wrong and we are aware. It should be no surprise to understand that we remain bullish and will re-engage the trade in similar fashions. We continue to have the same convictions in our projected trends in the market, but will increase our sensitivity to risk management. Cattle markets are not for the faint of heart, and these last several months could not have been more evident to that point.

Near term fundamentals still tell us nothing has changed in the data other than in the longer term we should see placement patterns begin to shift towards placing more cattle. Looking into and beyond the summer, we are waiting to see before we shift away from the clearer patterns in front of us. Meanwhile demand is getting better since retail prices have come down, especially for ground beef. One thing, however, that needs to happen throughout the north is pen conditions must improve. The northern market is a muddy mess and yields are definitely being affected. You can see this in prices first as a \$134 animal in the north, yielding 60%, costs the packer closer to \$223 vs a \$138 animal in the south, that yields 63%, costs him closer to \$215. This is a vital element to look at when doing week over week pricing analysis. It's clear most market participants do not.

In late January, the CME acknowledged that there are issues with the current cattle futures contract when they spoke at a public forum at the National Cattleman's Beef Association meeting in San Diego. While they did not admit HFTs were causing problems they did admit there are liquidity troubles and are starting to put in place a few measures that they think will calm the recent futures actions. The trade welcomed their efforts and we look forward to the continued focus on helping the markets function better. However we remain skeptical, as a student of the market we are going to assume they are merely treating the symptoms and not the problem.

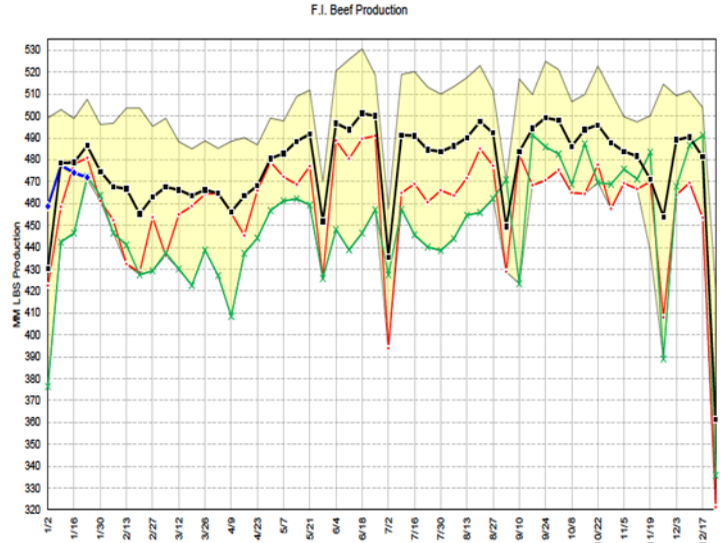
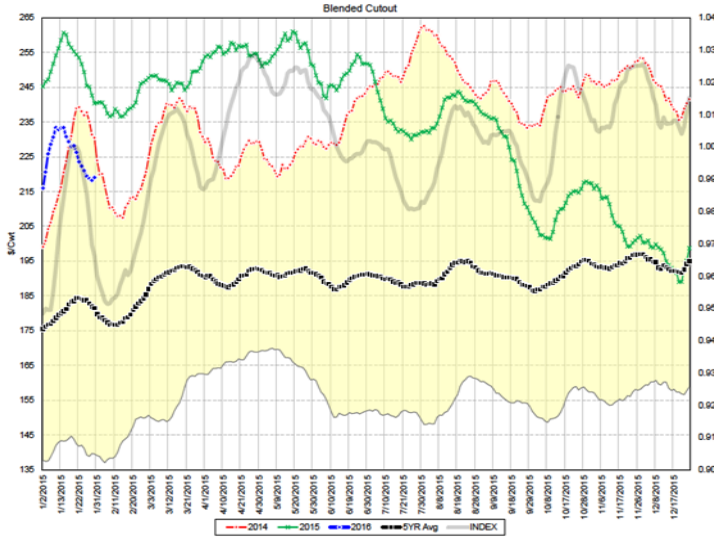


Trading futures contracts and commodity options involves substantial risk of loss, and thus is not appropriate for all investors. Investors should carefully consider the inherent risks of such an investment in light of their financial condition.

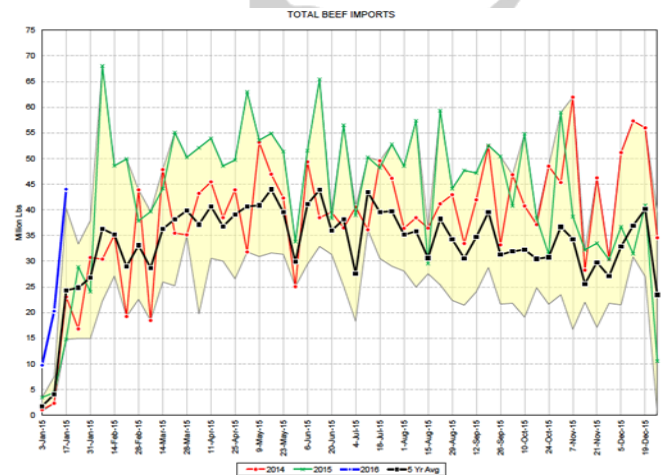
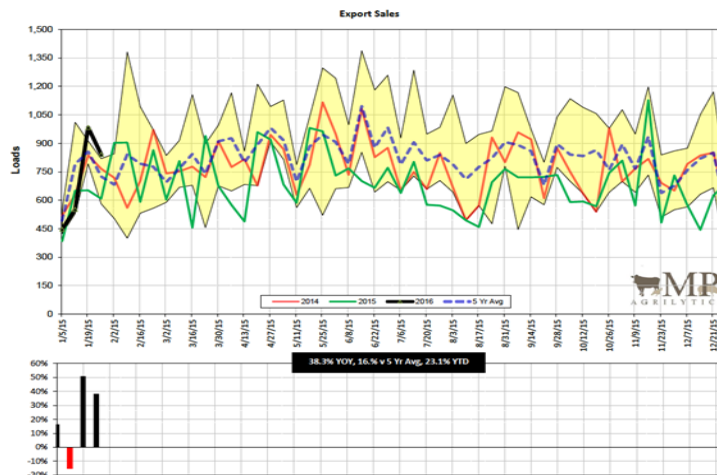
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- January's cash cattle prices moved from \$134 to \$138.
- Futures started at \$138, sold off to \$127, and ended the month at \$134.
- Basis moved from -\$4 to +\$4 during the month.
- Beef prices moved from \$205 to \$232 and back down to \$218 at month end. Retailers continue to do a good job buying beef on dips and have used this to lower prices. They seem to be sticking with those price patterns so far to start February.
- Slaughter levels hit their peak in January and will decline between now and April. Higher prices should result from now into the spring from this decline in supply.
- Exports continue to grow and as the affects of Australia continue this should put the US back into being a net export situation.
- Weights will continue lower into the spring.
- Weather continues to be terrible in the north amid warmer and continued muddy feedlot conditions. Blizzard conditions to start February will only make these situations worse.



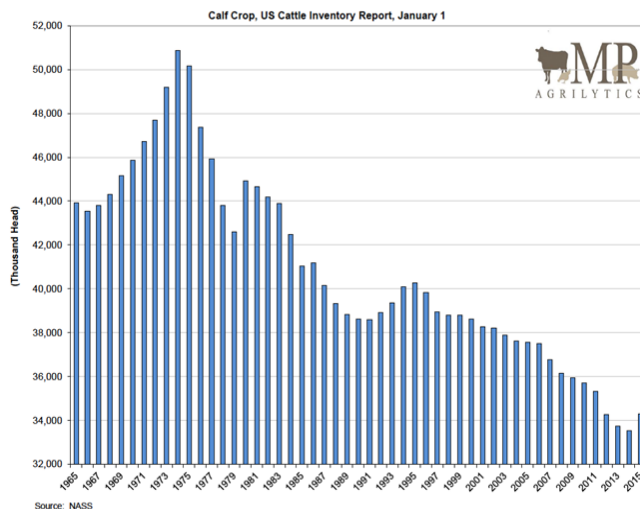
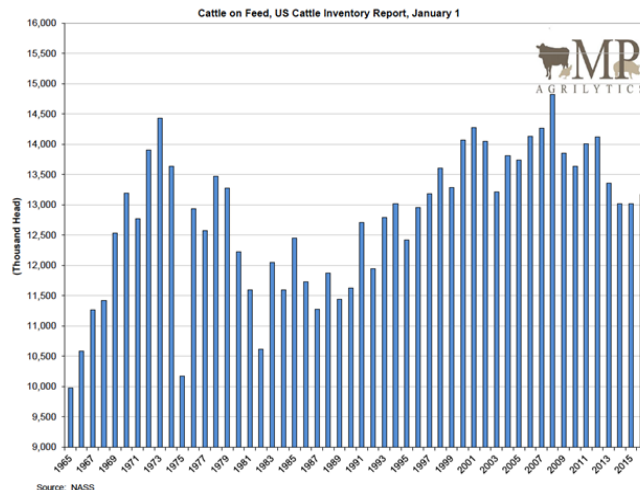
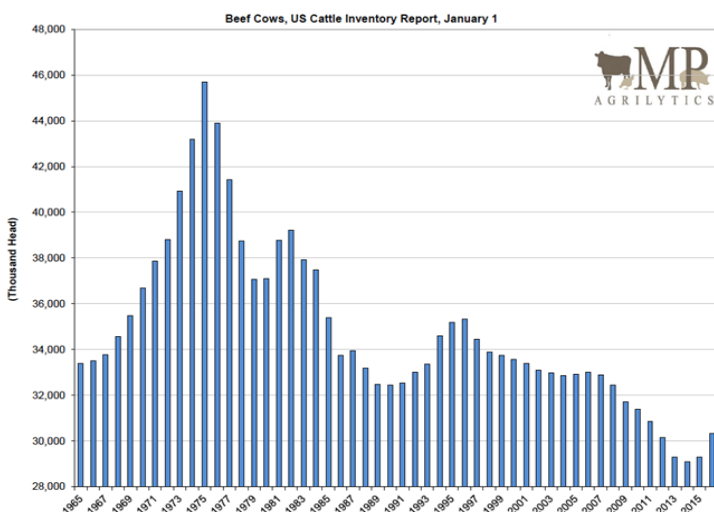
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January Cattle On feed has yet to show any signs of more cattle coming to the feedyards in total as players continue to fight poor yard conditions. As a result, heavier in-weights should be seen this spring and should be expected once we are able to get through all this weather and mud. USDA also gave us their view on the January 1<sup>st</sup> semi-annual inventory report. In Typical USDA fashion they posted more inventory (as everyone was expecting for the past 6 months) but they made a host of revisions to past data that they were wrong about. All cattle and calves were +1.8% amid the 657,000 hd revised down on past data. Dairy herd data was more or less flat, in line with expectations. Beef cows were +3.5% after accounting for the 391,000 hd revision to 2015 data. Heifers held for beef replacement were revised UP 309,000 hd which made that number +8.8% from a year ago. However, USDA merely shifted this out of the “other heifer” category bringing that previous data point down by 383,000 hd. It is not my intention to confuse but to recognize that USDA made some substantial changes to last years inventory, essentially reducing the starting point of the beef herd by roughly 400,000 hd. In essence, posting data that says *we are growing the herd but from a much smaller baseline*. The implication with this data is there should be more cattle to be placed into the feedyards this summer and fall. But when will that happen? Winter weather and very poor feedyard conditions will make that hard to happen now and if it does they will not feed very well.



Regards,  
Scott Shepard  
2/02/2016

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