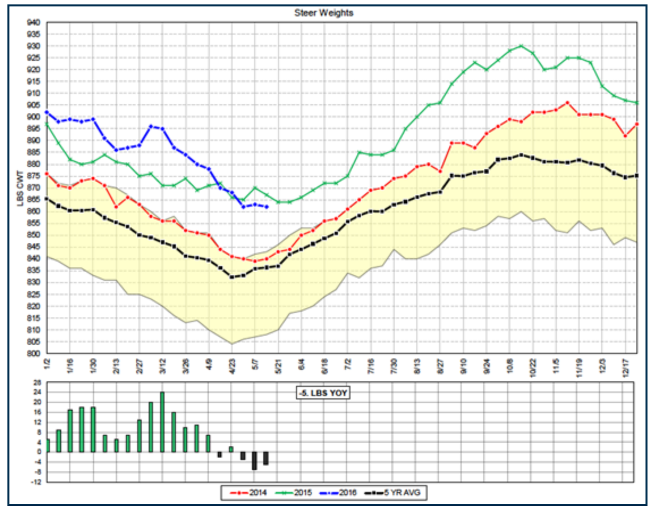
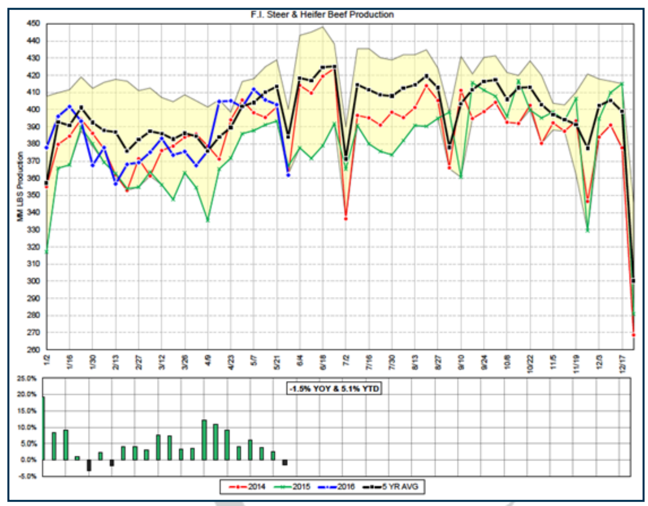
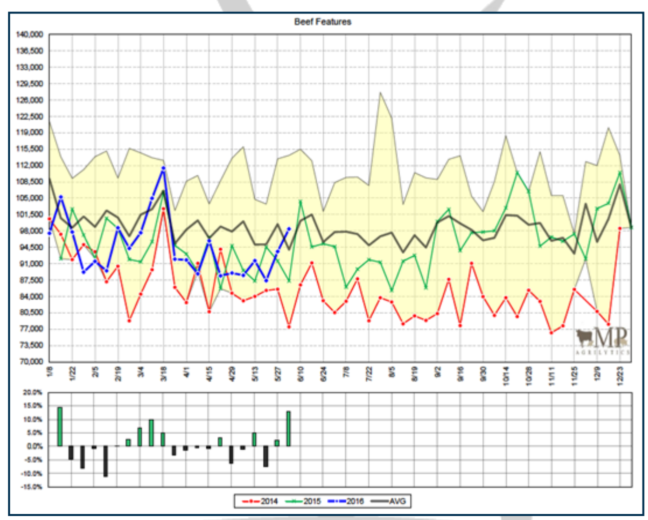
M & R Capital LLC

May 2016 Monthly Commentary

- Cash cattle prices dropped from $134 in mid April to as low at $122 in late May before coming back up towards $128 in early June.
- Beef prices were strong starting the month at $200 and rallying due to the Memorial Day holiday demand to $225 before ending the month at roughly $215. Memorial Day demand was strong and allowed the larger production from the cattle that were pulled ahead to move through the market with ease.
- Basis continues to be a struggle with futures at or near record wide discount to cash. Beginning of month basis stands at +$6 for options expiration.
- Slaughter levels have been much larger than expected in May. June will be the same if not lower. Lower harvest rates are also expected through July and August.
- We estimate that the number of cattle pulled ahead was roughly 200,000 hd or 25k hd per week.
- Placement levels are surging in the past 4 weeks as feedlots have marketed a record number of cattle in the past 8 weeks. However, these placement values in total are not more than the number of cattle that feeders have pulled forward.
- Pasture conditions have never been better and this grass will bid for feeders after this current May and June placement surge is completed. This should prove to tighten supplies for November through February.
- Weights continue to erode and are now under a year ago. Seasonally weights bottom now and increase into the fall. However, we expect weights to continue to be well under a year ago as this happens. The current 7% reduction in total weight is expected to be a much greater reduction this fall.
- The US Dollar is collapsing and US cattle prices are the closest they have been to that of Australia in several years. This will increase exports and reduce imports as we look into the second half of 2016.
- Chinese imports of US pork continues to be very supportive to the US hog market and is expected to continue through July at this point. Beyond that we are skeptical.







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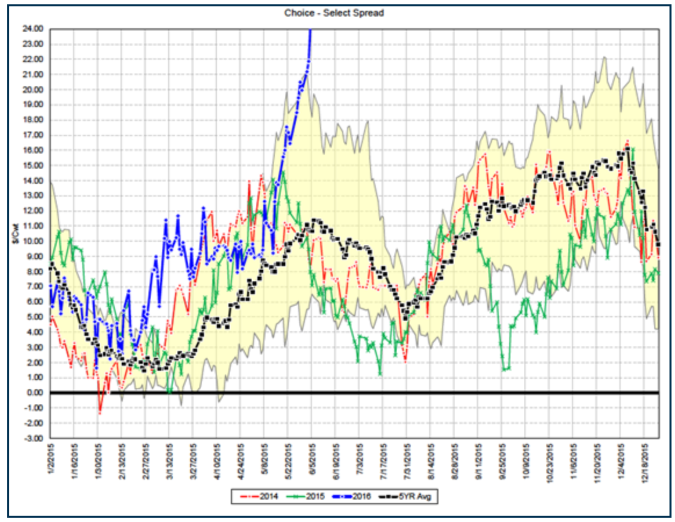
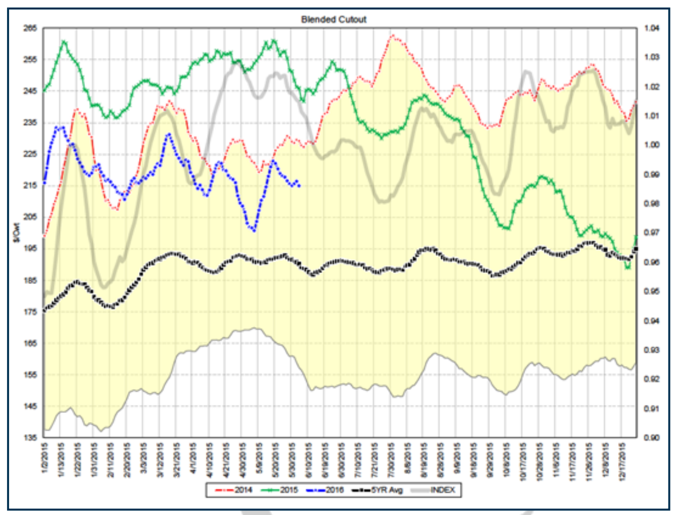
May 2016 Monthly Commentary

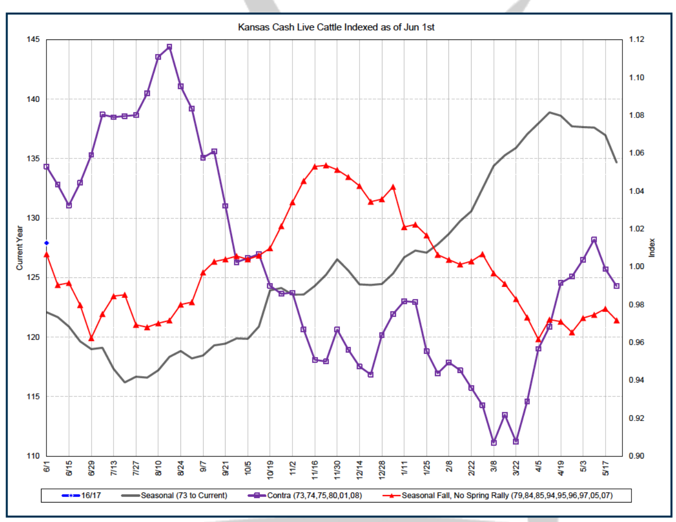
The market has moved through an extraordinary marketing event. Since the end of March the feeding community marketed a large number of cattle ahead of schedule. This was done in an effort to minimize balance sheet devaluation by feeders in case the futures market continued lowering. The industry has affectively dropped 108 pounds off the herd since last fall or 7%. Feeders pulled May cattle in April and June cattle into May in attempts to minimize their equity devaluation from $135 cash prices fearing the futures at $115-$120. As long as there is more than a $5 cash premium to futures, feeders will continue to pull cattle forward. The feeders desire to market cattle is the biggest fundamental input. It is more important than placements or anything else. Now that they have finished the water shed of April and May the question remains will it continue and to what degree. As long as cash prices are in the low $120s they will not, but over $130 they will. It is that simple.



The other important change to the market this spring was Walmart starting a demand test where they are creating their own private label angus beef product. This is being rolled out at a few specific demographic cities that they think they can have the most success. It is a main reason why the choice – select spread is coming out to all time record wide price levels. If their test pilot turns out to be a normal standard of choice it will mean much more demand for the future—something we will be watching very carefully. The greatest misunderstanding that the current trading communities do not understand is that with the choice-select beef spread at an all time record wide level at $24 the formula cash prices are much higher than the spot market, sometimes as much as $4 to $6 higher. This is spurring a tremendous basis argument in the trading community.



We still conclude that futures prices are over estimating the impact of the pending supplies this summer and for beyond this fall. All everyone wants to price in is the two year public discussion of expansion. No one wants to talk about the growing demand curve, the affects of the US market almost moving to a discount to the Australian market, or the collapse of the US Dollar that will reduce US beef prices to the world markets. As a result we should see the futures narrowing basis more in the coming weeks than it has in the past. As expected this $115 to $108 area proved to be important support for trade as we bottomed around the $112 area in the August contract and should be moving in the lower to mid $120s in the coming weeks. Whether basis narrows or not will be determined by the funds and how they respond when the market approaches this level. This $120-$124 area was an important area that triggered their relentless selling earlier this year so will it equally turn them into super buyers is the question?



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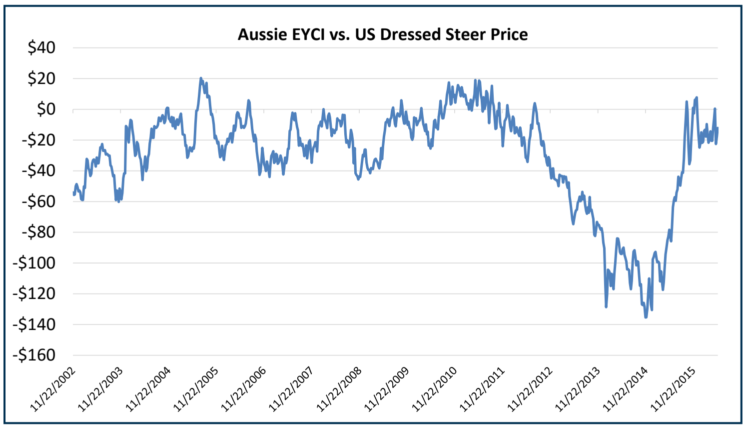
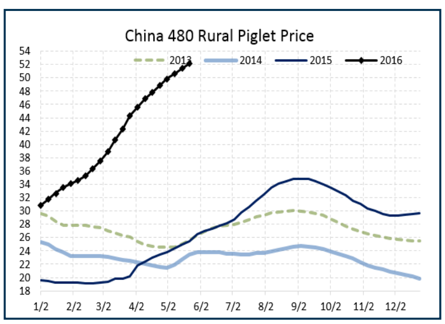
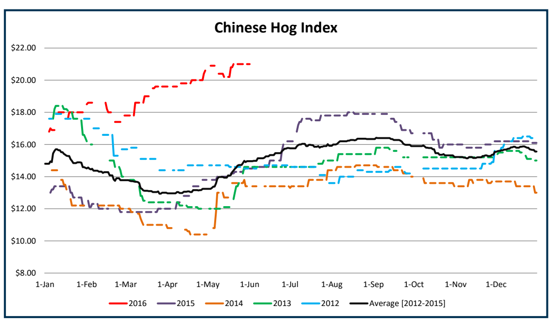
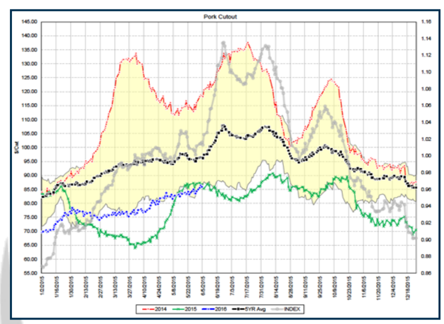
The Australian markets continue to evolve as we have expected with harvest rates still being well under a year ago. There is no change in our outlook here. Imports, as a result, are running short. Imports are at a point where they will seasonally begin to decline from here into the fall so this situation is expected to reduce net supplies.



We continue to monitor Chinese pork prices as it has been something of a concern. However, now that the public is writing about it we are actually looking for spots for it to stop. These markets will be getting our attention as our focus will be shifting into where and when to be short as we move through June and transition into July.







We were able to re-engage our delta hedging options strategies from the end of April through current pricing periods. This allowed our positions to move with the volatility of the market rather than at its expense. Thus allowing us to yield greater returns while reducing the risk. It also allows us to trade around our base. This is something we will continue to engage in unless of course we decide to get flat. As our model is still increasing demand and now having pulled supplies ahead, we have engaged what was the most discounted part of the market. As this changes we may decide to get flat or shift back in the curve. A shift back will need weights continuing to drop and the placements to fall as grass feeding takes all the feeder cattle off the market later this summer, which we anticipate could happen.

Regards,
Scott Shepard
6/7/2016

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