M & R Capital LLC

July 2017 Monthly Commentary

Monthly Recap:

	Week Ending 29-Jul		Week Ending 1-Jul
Kansas Cash Trade	117.50	-1.35	118.85
Blended Beef Price	201.52	-15.08	216.60
August	112.90	-3.65	116.55

- Cash cattle prices started the month at $119-$120 and eroded through the month down to $117-$118 at month end. Prices failed to keep pace with the declines in beef as cattle feeders are so current they resisted the market's decline. Marketing's continue to out pace placements allowing feeders to maintain an upper hand in being current. Basis widened from $2 to $4 as futures moved down faster than cash because of increased fund long liquidation. Seasonally, the market is looking for its summer lows.
- Beef prices continued their seasonal collapse hovering around $200 at month end, dropping some $15 during the month. Prices are down to levels that create substantial retail margin and with the recent declines in the U$ dollar export shipments reached their highs of the year last week. As a result forward sales have started to uptick and retail features will move back into the forefront of the demand curve. Retail margins are big for beef with ground beef, end cuts, and strip steaks being the most desired while chicken and pork retail margins have been depleted to almost zero. While prices may not be ready to surge seasonally, they are certainly showing us strong signals that they are bottoming. Demand from exports and domestic players will get better every week from today into next spring. $200 beef prices and the assumption of a $100/hd packer margin equals cattle prices at $120. Futures today are at $112.
- Placement rates have been larger than expected yet our marketing rates continue to exceed the placement rates. As a result, total Cattle On Feed supplies have peaked and will begin to move sharply lower from now through the end of this year. One thing that bothers us about the recent data from June and July is that these months are some of the smallest placement months of the year. As compared to September, October, and November which are the largest. Placing 16% more cattle in June and 9% more cattle in July is only a total of 400,000 hd spread out of 6-9 months. We have seen the 2nd largest Dec-June placement figures noting a year over year increase of 11% or 1.33M hd with a majority of these animals harvested or markteted ahead thus far. This leads us to question of what the remaining placement supplies will be in July through Dec, the largest placement periods of the year. Knowing that July is +9% that leads us down the path that the final 5 months will be flat to as much as 10% smaller. If you see data that is 3% to 4% smaller that data will be RECORD SMALL for July-November. This is my point to the comparison between the summer placements and fall placements. At -5% in total that will be 500,000 hd or 100,000 hd less that what we have just seen. As you can see It's not "more" cattle as the market is talking about and certainly pricing into the strip of forward prices. As an example: February averaged $120 in 2017 and April averaged $128, this compares to 2018 contracts that are both priced at $115.
- When we started looking at slaughter rates for this summer's forecasts we have done a great job chewing through the larger inventories and are not having a labor problem like many have feared. We are currently harvesting 625,000 to 635,000 hd with ease. This is a testament of demand that has increased year over year and is expected to continue. Peak supplies are right now but clearly as we outlined above supplies will be declining beyond this September. However, what will our demand base be? Let's assume that today's 625,000 hd is the baseline to start, if that is true the available supply might be only be 600,000 hd in the future, certainly into early 2018. For the time being supplies are matching up with demand but in the future there is the reality that demand will out stretch supply. This comes domestically as well as through exports.
- Packer margins remain very good, currently at roughly $130/hd if you sold nothing and were all on spot. Margins are $180/hd if you sold 40% of your beef 2 weeks ago with cattle at $117. If beef stops at $200 like we discussed a $200/hd margin puts cattle at $112, at a $100/hd margin it puts cattle at $120, and into the winter highs $130. So it's clear to us that the summer lows should be no lower than this $112/$115 area with margins maximized and supplies peaking.

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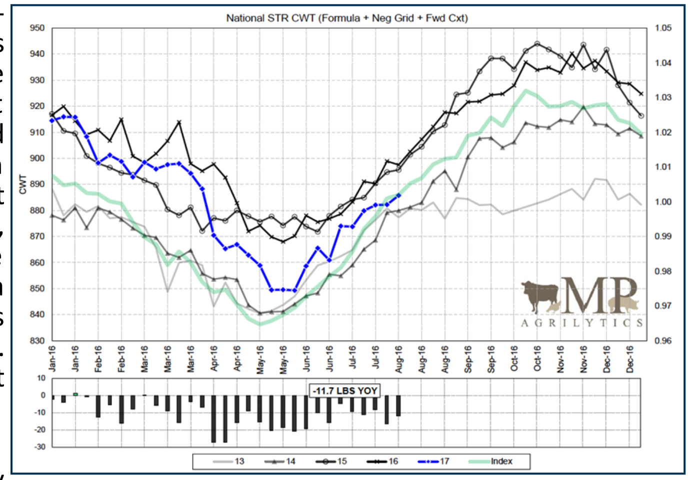
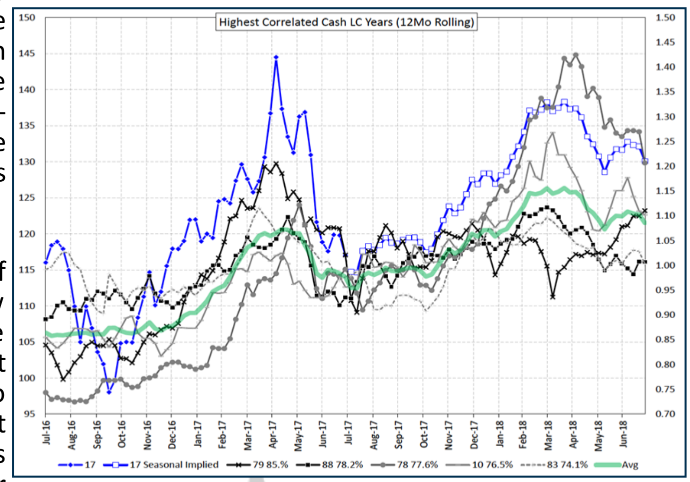
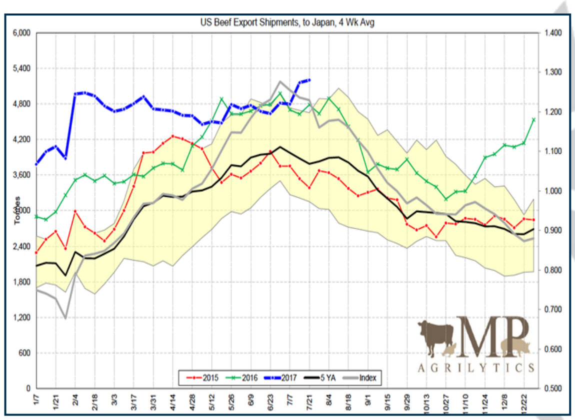
- Weights remain lower but have seasonally bottomed. Excessive heat has slowed the seasonal increase in weights as they have flat lined here recently and should continue that way on this and next week's reports. We expect weights to gradually increase through the summer and peak in the fall but remain 10-15 lbs. under a year ago in 2017. Packers are currently talking to producers about limiting or eliminating the use of Optiflex, a feed additive, that can't be used for exports to China. If more of these efforts bare fruit then weights will drop in early 2018 at a more rapid rate than we would expect seasonally. This is something we have to stay on top of for two reasons. First, it reduces production but secondly, it means that export demand will be larger than expected.



- Seasonally, the cash market is expected to bottom in early August. 2015 and 2016 were exceptions to the rules as the futures markets in those years were premiums to cash and carried the cattle into the fall vs keeping them in the summer. 2017 we have seen cattle pulled ahead all summer, leaving no carryover into the fall. As you can see from the charts, when you take out the past two years prices move higher from here.



- Recent events have found that Japan will raise the tariff on "frozen" beef imports from the US, Canada, and New Zealand from 38% to 50%—a modest jump. However, the one thing that most media outlets fail to discuss is that most of the Japanese demand is for chilled beef. If Mexico is not on the tariff list then current frozen supplies that are in question can easily move through current channels either through Mexico or shift from frozen platforms over to chilled platforms. As you see in the chart, beef shipments to japan seasonally decline into the coming months every year. As a result, we don't expect there to be any disruption to trade with the US and Japan over this recent event and we should only see a normal seasonal decline in the weeks and months ahead.



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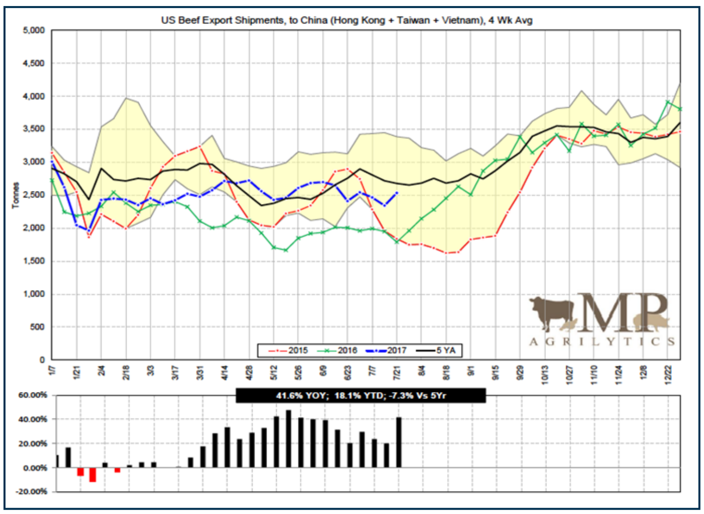
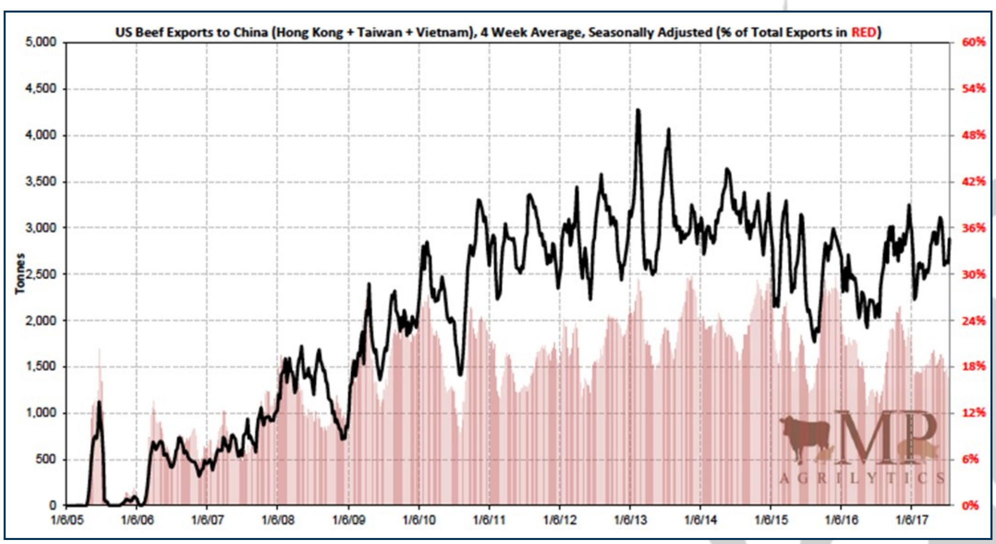
- As you may have read in the recent months the US and China have agreed to new regulations with regards to US beef moving directly into mainland China. The regulations have been thoroughly digested by the market, US prices have dropped from $250 to $200 in the process and the U$ dollar has dropped from $98 to $93. This all makes the US a very attractive option for Chinese buyers. Buyers are actively attempting to buy US beef but sellers are playing it slow to insure they are getting the 'rules' correct in order to maintain control over the process and make sure they own something before they actually commit to a sale. Some entities in China are partnering with smaller regional processors and feedyards, working with them to put the cattle on the ground in order to control and insure the supplies. Others are trying to buy meat forward with others still bidding on the wholesale market for what is still a premium product based on the rules for trade. Any large trade has yet to be seen but clearly things are moving forward. We think the market is grossly discounting the future demand that China will be pulling from the US. It is also possible for the Brazilian markets to see production shortfalls. As a point of math, if the US gets just 10% of Brazil's market share in the global beef trade with China it will double the US export volume from 3,000 to 6,000 tones.





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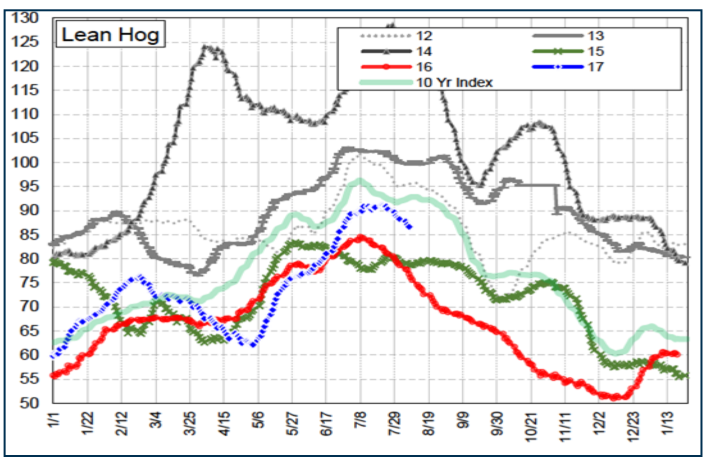
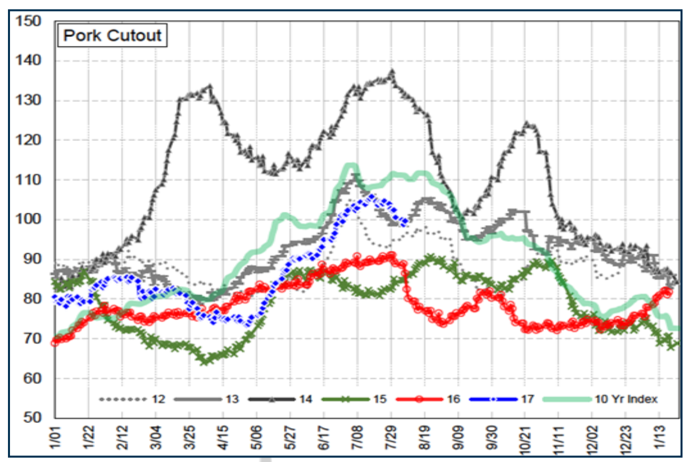
Thoughts on Hogs:

- While US beef exports are starting to baseline and poised to increase to China we are seeing hard data that US pork exports to China have been falling and will continue to fall through summer and early fall. With US pork prices $10 higher than that of the EU it will be a race to the lows to find out who wants demand more. Current US pork prices are at $100 while they are $90 in the EU. US futures say they will be $70 come this fall. This implies US hog prices should be between $55 and $60. Seasonally hogs have topped for 2017 and are in the process of hunting for their seasonal bottom. This is expected to come in October or November most likely. Producers are actively pulling hogs ahead from September into August and from October into September in order to minimize the number of head that are effectively devalued on their balance sheet from July at $90 to August at what will be $80-$75 and October that is $64 today and might be sub-$60 soon. December futures are currently near $60. The funds are loaded and are still big longs in the October and primed for a long liquidation sell off like we saw into this spring when prices went from $83 to $68—$15 decline in prices. Typically we find a $30 break from the summer highs to the fall lows, which would imply a price at $60.





Thank you to our friends at MP Agrilytics for their data and charts.

Regards,

Scott Shepard

August 2, 2017

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