M & R Capital LLC

January 2018 Monthly Commentary

	Week Ending 3-Feb		Week Ending 30-Dec
Kansas Cash Trade	126.00	3.00	123.00
Blended Beef Price	206.28	8.34	197.94
April Futures	122.92	0.50	122.42

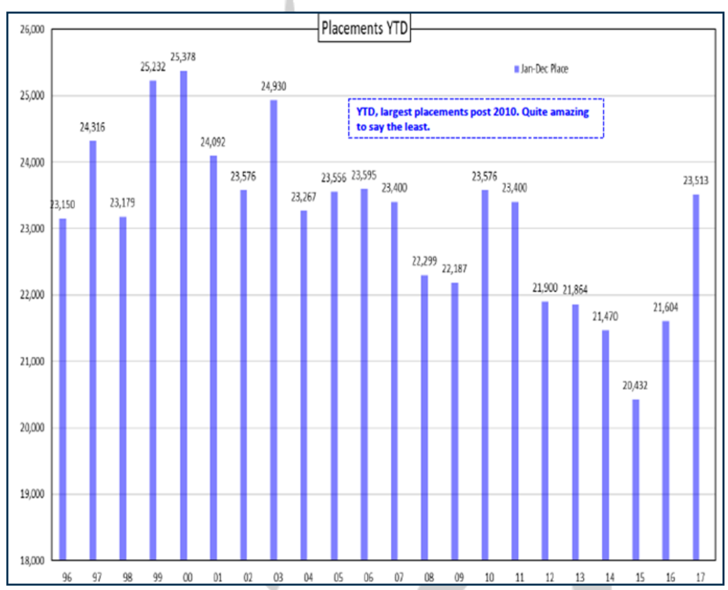
Cash cattle prices started the month at $123 and jumped to $126 by month end despite a continued focus on reductions in harvest rates by packers. The first winter storm of the year hurt feeding conditions in the north and pushed cattle back a bit with wind, snow and cold on two occasions in January. Days are longer and weather will soon be warming so the affects of weather are temporary if none at all in the trend of things. By comparison severe to extreme drought conditions are affecting Kansas, Oklahoma and Texas. It has not rained in over 120 days in the south and in Kansas conditions date back to 1953 for comparison. This is the 18th driest January on record for Oklahoma and 21st driest for Texas. Actually, a bit surprised that Kansas only ranked as the 42nd driest.

Basis strengthened with cash running roughly $2 over futures where it remains today. If you recall, basis shifted from futures discount to cash in the summer to futures premium cash all fall. Today, cash is back over futures. While this should be a signal to stop holding, cattle feeders are not yet ready to pull spring supplies ahead.

Beef prices moved higher seasonally as retailers and exporters got back to work to start the year. Exports were the standout trade with domestic sales struggling. Exports were big particularly to Japan and South Korea. Cuts in particular were Chuck rolls, short ribs, and flanks/skirts. The Olympics being in South Korea are a big part of the South Korean buying patterns over these past months. Ending 2017, annual exports were +12% at 948 mt. Standout country breakdowns as follows: Japan 258.3 mt +27%, S. Korea 171 mt +3%, Mexico 116.3 mt +7%, Hong Kong (China) 116.3 mt 15%, Total Asia 622.5 mt +16%, Total Asia less Japan 364.2 mt +9.5%. Ending 2017, annual imports totaled 1,105.7 mt which is steady with a year ago. Standout country breakdowns as follow: Australia 231.6 mt -9.4%, New Zealand 184.8 mt -9.1%, Canada 257.2 mt +4%, Mexico 211.0 mt +15.3%. Australian supplies are starting to show the fruits of their expansion over these past 2 years as production is starting 2018 +9% over a year ago. This will compete with US production that is expected to be +5 to +10% this spring and summer.

Total Cattle On Feed are +8%; Heifers On Feed are 571k hd which is +16% and the largest since the drought of 2011. Placements rates have been 10 consecutive months of being 4% or more higher than expected. This amounts to 1.2 mln more placements than anyone expected. Yet futures prices are higher today at $125 vs last year this time at $116.

Placement rates in January continued with the 2017 trade being larger than expected at +1% as dryer than normal weather keeps pushing cattle into feedyards earlier than normal. This will have two effects on the market. First, it will potentially create record marketing rates this spring and all of this summer. Second, it will reduce the availability of yearling placements this coming spring and summer (Q4 2018 and beyond supplies).



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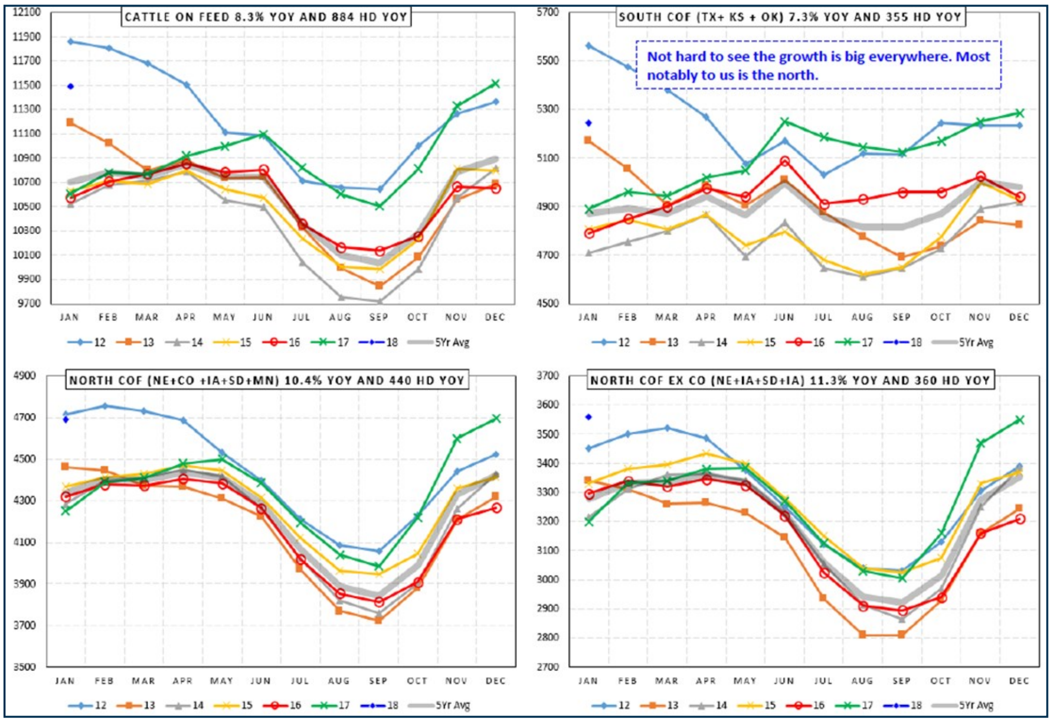

I don't have an answer to how we are going to overcome the supply that is currently in the feedyards and the plant capacity issues we might have in 2018. Adding to this fed supply we now have an additive issue to deal with as dairy cow slaughter is going to be forcing added liquidation of the dairy herd. Producers are being forced to increase the slaughter of their herds in order to better match supply with demand. Milk prices are depressed and cow prices are depressed leaving them with no options. If cattle do not move out into the forward curve and get stretched out into the fourth quarter we will have troubles. However, with the current spread relationships in the futures today that will not happen. This is something we will be looking to trade and strategize around, being the spread relationships that need to shift to incentivize these ideas.

Packer margins have remained very thin after collapsing to roughly $25/hd. To start out the first part of February margins are moving into the red. This will keep packer slaughter rates depressed which will discourage marketing rates at the feedyard level.

Weights have come down from a January bout with weather. Seasonally weights will come down but we expect them to fall less than seasonally expected.

You have heard us talk about $130 as an objective for last fall and again in Q1. The December failed to get there and the market is going for that number here again in January and early February. The data says that when we move cattle contra-seasonally into the feedyards like we have the spring highs come in either early February or early March and proceed lower from there into the summer. What concerns me is that packers slaughter rates are depressed more than I would like to see, which makes me think that the highs are now instead of in early March. Summer lows are expected to come in July and will be determined by the ability to either move or chew through the burdensome inventories we have on the ground. If slaughter rates are able to keep pace with the 650-670,000 hd supplies we have, prices should test and could bottom around $100. However, if we are not able to pull through the inventory then the depressed prices will extend themselves through the later summer or early fall.

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Based on current demand and the prospect for growing supplies in April, May, June, July and August combined with the packers limited slaughter rates we think this beginning of year rally will be short lived. Our focus started in early November and again here in early February. We are focused on short only programs and bear spreads for the obvious reasons shown in the S&D. We are comfortable being long volatility and will continue to use options to hedge our positions. The focus for us will be bearish the spring and summer contracts. Adding to shorts on rallies and looking to be bear spread vs the fourth quarter.

After peaking at $128-$130 in early November the market has come back up to $127 in early February. We still believe prices will be capped by the $125-$130 area for February and April and $115-$120 for the summer contracts. Downside potential will be determined by the packer's ability to increase slaughter capacity.

Funds continue to view the market as an inflationary play using CPI and GDP long term correlations to forecast a 15% increase in prices into this spring. The also think less feeder cattle will be available in 2018 and that is the backbone of their logic. As bad as the drought is in the southern plains it is clear to us we have more cattle on feed than anyone expected and a larger cow herd. If Feeders become less available it will come later this spring and summer, which will be our supplies for November and December of 2018 and beyond and not this spring and summer where the funds have placed their bets.

The markets big issue with pricing in 2018 is shown by the chart below for harvest supplies. Last year we had no cattle for the spring. Prices moved up to $140 and basis strengthened out $10 to $15 in order to draw out inventory out of the summer into the spring. This year we have more than a plentiful supply so this move in prices should not be needed to encourage supplies to move, which in itself is another issue. As you can see if we don't move the cattle away from this early summer time frame we might be pushing up against capacity constraints.

We will be increasing our risk platforms as we focus on the above strategic thoughts and ideas.

Regards,

Scott Shepard
February 7, 2018

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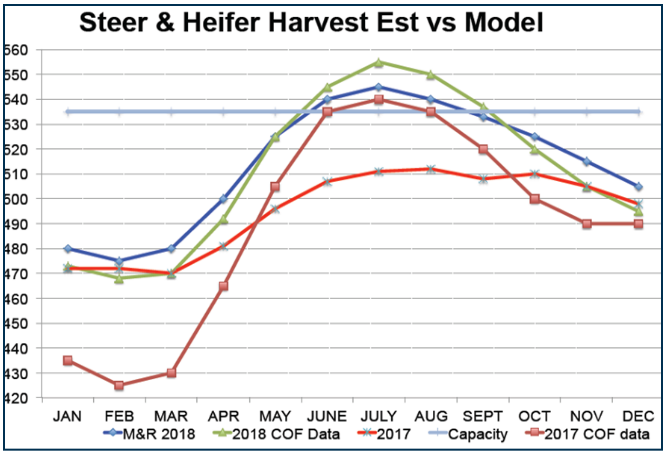

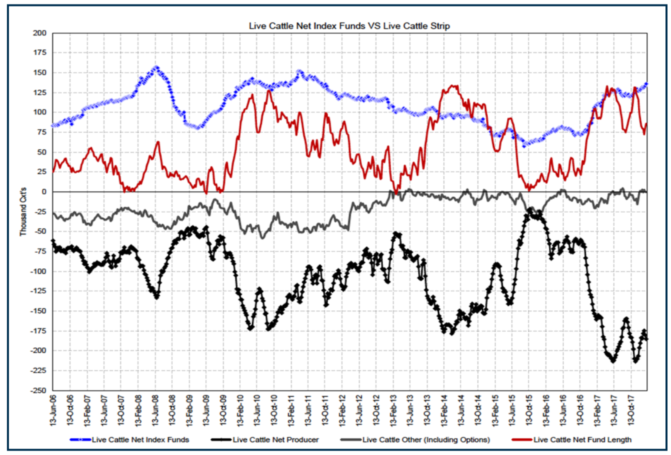

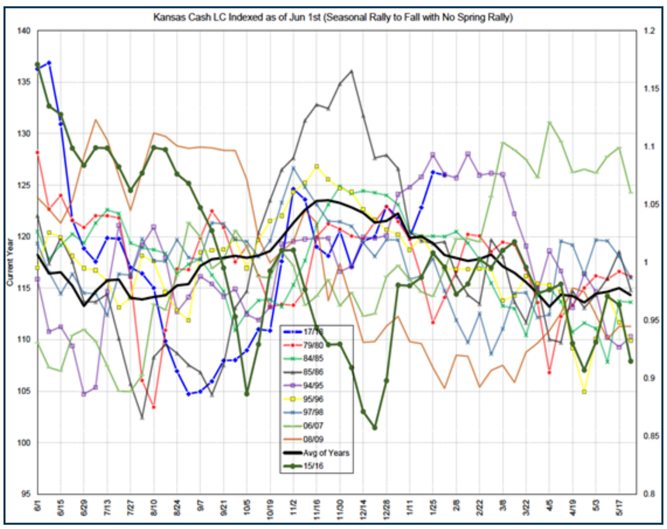

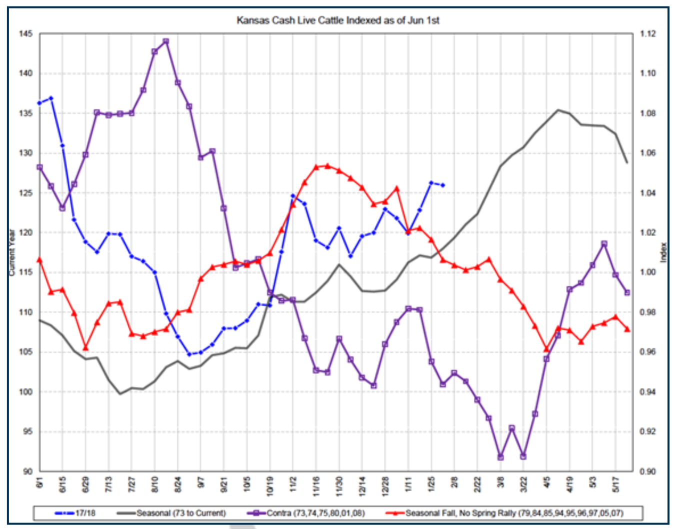

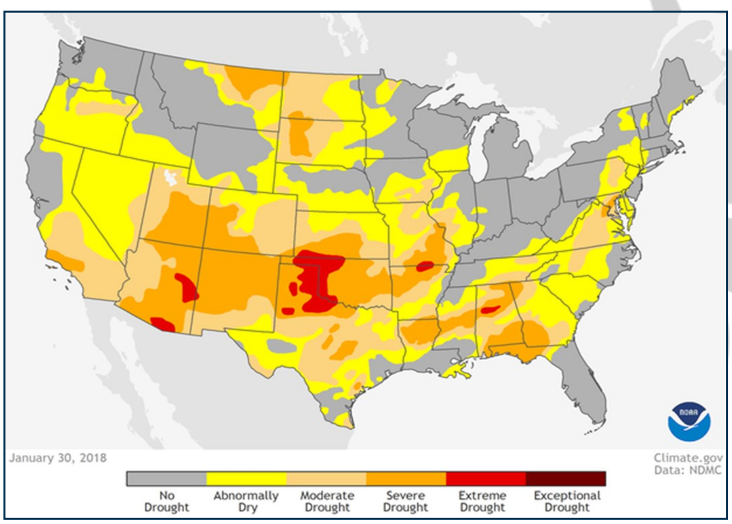

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