# M & R Capital LLC

## February 2018 Monthly Commentary

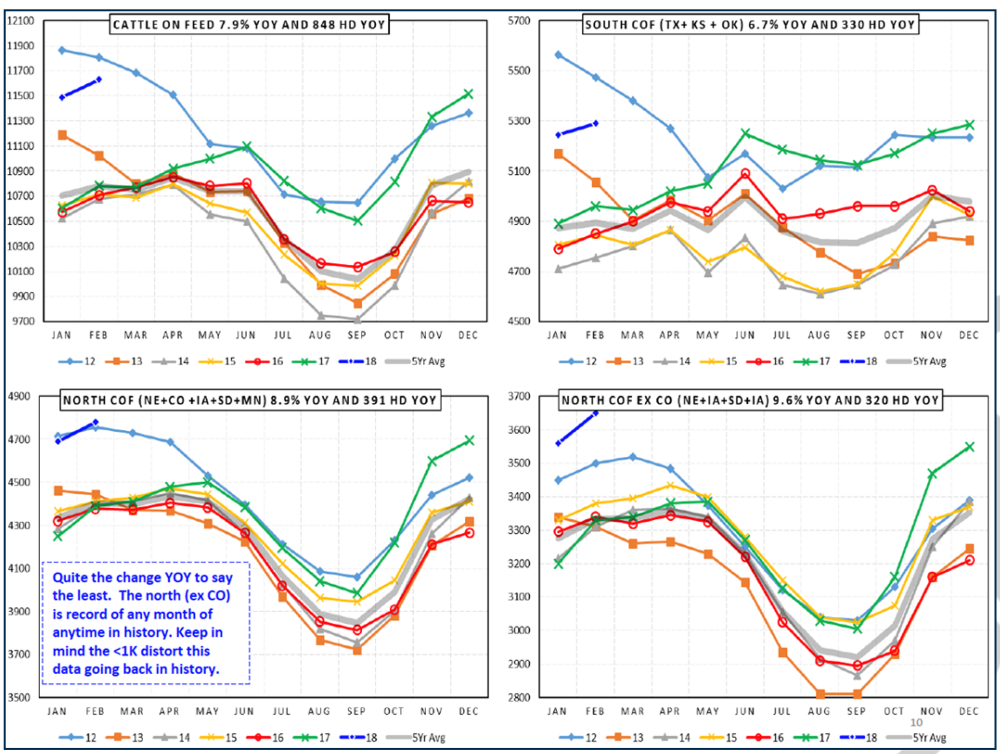
Cash cattle prices started the month at $126 and jumped to $128 by mid-month and stayed there through month end. Harvest rates continue to run smaller than expected between steady and +4% with a year ago while total Cattle On Feed remains 8% more than a year ago. Weather is turning from winter events to spring events in the north while extraordinary dryness continues to be seen in the southern plains.

| | Week Ending 3-Mar | | Week Ending 3-Feb |
|---|---|---|---|
| Kansas Cash Trade | 128.00 | 2.00 | 126.00 |
| Blended Beef Price | 219.37 | 13.09 | 206.28 |
| April Futures | 121.90 | -1.02 | 122.92 |

Basis strengthened with cash running roughly $4 over futures at month end with Cash trade +$2 and futures -$1. This should help signal cattle feeders that they should stop holding cattle and increase their marketing patterns. Supplies are poised to increase here forward into the beginning and through the later summer.

Beef prices are moving higher seasonally as packers maintain a stranglehold over retailer needs by keeping harvest levels extremely low during the month. Exports continue to be the standout trade with domestic sales struggling. Exports continue to be strong to Korea and Japan. However, with the smallest harvest rates behind us and strong increases each week coming April through August, exports are going to need to surge in order to keep pace with production. Australian supplies are starting to show increased flows as dry conditions there are adding production into Asia as well as the US.

USDA posted the Feb 1st Total Cattle On Feed during late January at +8% compared to a year ago, once again showing larger than expected placement patterns for January. The March 1st On Feed data is expected to continue this trend and will be released in the coming weeks. We think they will come in at +9% compared to a year ago, adding even more on feed inventories to the already burdensome summer supplies.






Poplar Avenue, Suite 101 • Germantown, TN 38138

newaccounts@mnrcapital.us • Tel: 901-766-4446 • mnrcapital.us

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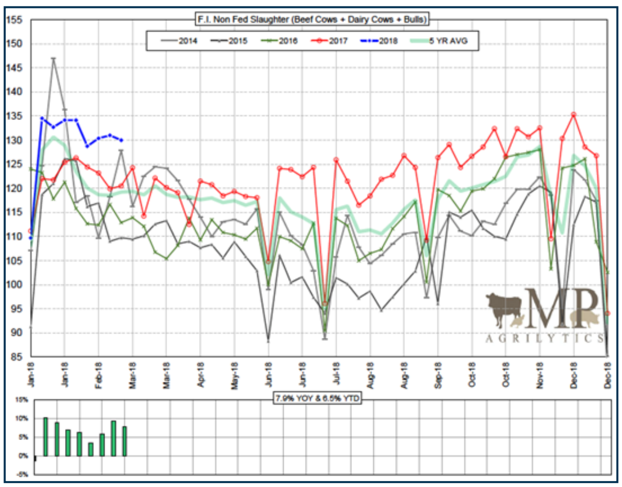
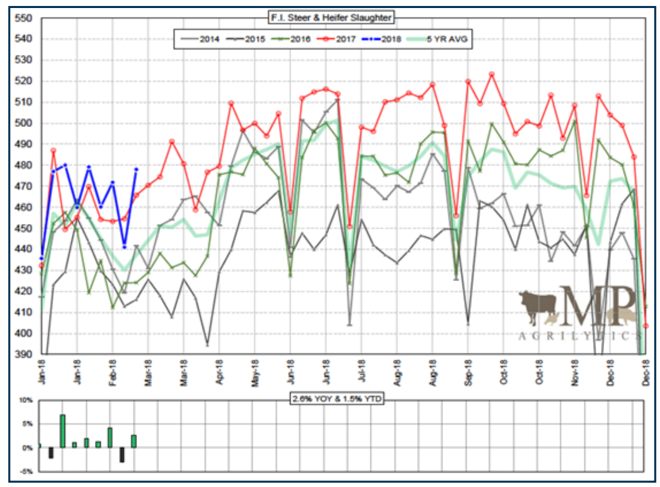
Placement rates in January continued with the 2017 trade being larger than expected at +4.4% as dryer than normal weather keeps pushing cattle into feedyards earlier than normal. This will have two effects on the market. First, it will potentially create record marketing rates this spring and all of this summer. Second, it will reduce the availability of yearling placements from May through August (Q4 2018 and beyond slaughter supplies). February placements are expected to be large again at +5% or more.  The Iowa and Nebraska cattle feeders have the largest inventory of cattle on feed on record. Iowa specifically placed the most ever cattle on feed in January we have seen in the history of the USDA data series.




I still 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 the spring and summer of 2018. Neither the basis nor the futures markets spreads are moving enough to encourage the cattle to move.

Packer margins have started to widen out seasonally and will continue to do so from now through the entire summer. Margins are expected to be record wide this year. After being at $0 towards that end of January margins are starting out in March at about +$100/hd.

Weights have come down as you would expect them to during the winter. Seasonally weights will continue to come down but we expect them to fall less than seasonally expected.

You have heard us talk about $130 as an objective for Q1 cash trade. The data tells us that when we move cattle contra-seasonally into the feedyards like we have, the spring highs come in early February or early March and proceed lower from there into the summer. What still concerns me is that packer slaughter rates are depressed more than I would like to see, which makes me think that cash has topped for the spring. We can always hold cash trade steady here especially amid higher beef prices, however, here forward into the summer I expect cattle prices to erode. Slaughter rates are expected to be able to keep pace with a 640-660,000 hd supplies each week as we look into April, May, June, July and August at this time. If we are not able to pull through the inventory and maintain the kill levels every week consistently through the summer we are likely to carry cattle throughout the summer into the fall.

Based on current demand and the prospect for growing supplies in April, May, June, July and August combined with the packer's limited slaughter rates we were forecasting that this rally which started the year will be short lived. Our focus

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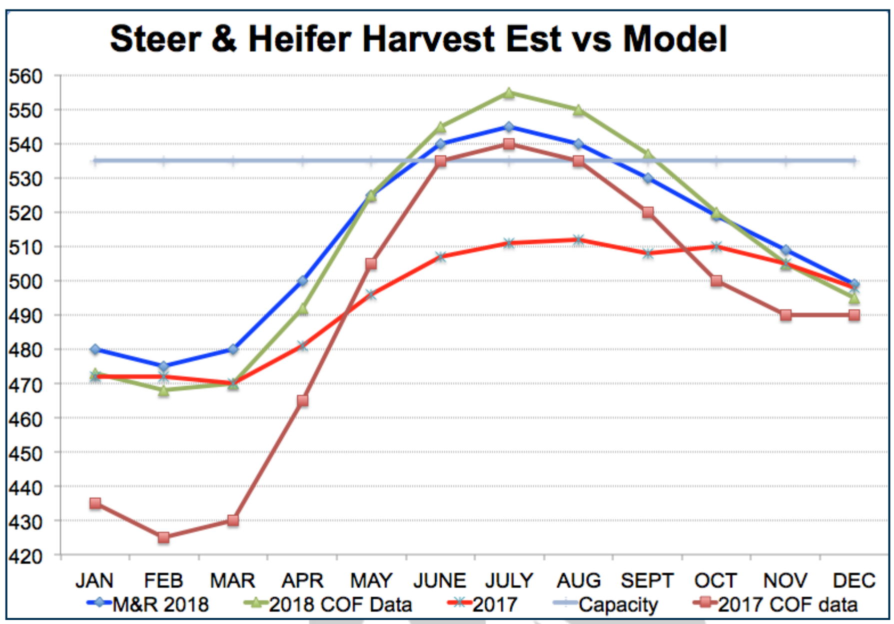
started in early November and again here in March. We are focused on short only programs and bear spreads for the obvious reasons shown in the S&D. We are comfortable being long volatility and will continue to use options to hedge our strategies. The focus for us will be bearish the spring and summer contracts. However, as the longs roll into the summer months we will roll our shorts with them. We are adding to shorts on rallies and looking to be bear spread vs the fourth quarter.

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. After pushing into ever larger fund long positions from $120-$128 early this year their average buying power seems to be vested around the $124 level with the market closing at $122 to start the month. $122 then $120 and finally under $118 are expected to be levels where longs will start to see the pinch and increasing liquidation event could be seen. As bad as the drought is in the southern plains it is clear to us we have much more cattle on feed than anyone expected and a larger cow herd. If feeders become less available it starts to be seen in April, May and June. However, with On Feed supplies record large in spots in the country it might not matter that feeders become less available if yards struggle on marketings (and kills are not big enough).

The market's 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 a more than a plentiful supply so this move in prices should not be needed to encourage supplies to move nor does basis "have" to move if it doesn't want. 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 strategy thoughts and ideas.




Regards,

Scott Shepard
March 6, 2018



Poplar Avenue, Suite 101 • Germantown, TN 38138

newaccounts@mnrcapital.us • Tel: 901-766-4446 • mnrcapital.us