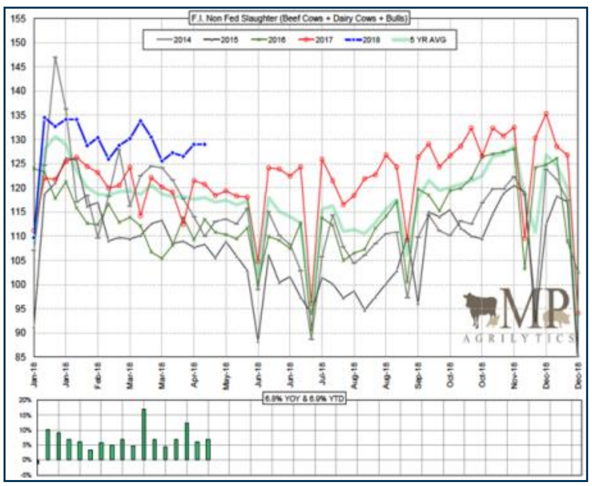
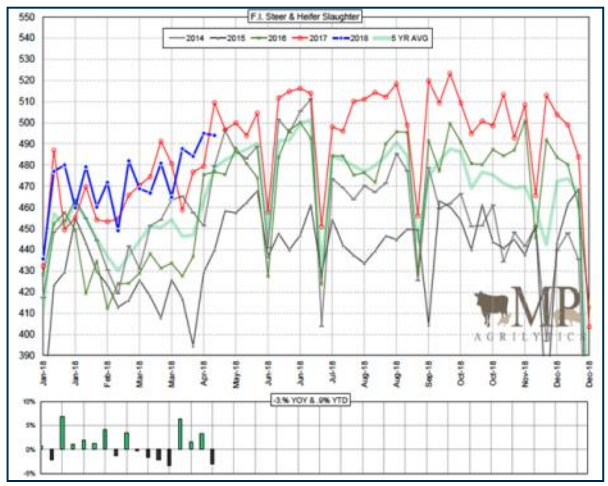
April 2018 Monthly Commentary

	Week Ending 27-Apr		Week Ending 30-Mar
Kansas Cash Trade	126.00	5.00	121.00
Blended Beef Price	214.87	0.07	214.80
June Futures	107.22	4.65	102.57

Cash cattle prices started the month at $121 and rallied to $126 by month end. Seasonal increases in retail beef demand led to increased packer demand for live supplies and harvest rates. Despite pulling cattle ahead from May packers needed to compete and pay up for cattle. Harvest rates have been running lower than expected compared to a year ago but that is expected to change drastically into these next few weeks and months. Cow kills have been much larger than expected at roughly 7% more while steer and heifer kills have been only about 3% more. Steer and Heifer slaughter has been running about 495k hd a week and will jump to 520k hd in May and 535k hd in June. Cow slaughter has been running around 128k hd a week and is expected to hold steady but slightly lower at 123k hd through the summer. That adds up to roughly 658k hd a week in June or about a 5% increase in supply from current levels which matches up with placed against supplies from the past few months and the On Feed data that is +8%.





Basis continued to strengthen with cash running roughly $18-$20 over June futures at month end. Feeders are pulling cattle ahead from May and June to capture this basis. This is pulling weights down but not really pulling many cattle away from the big supply in June and July just yet. Feeders will continue to market cattle as longs as basis remains strong. This will be the first step in fixing the summer bulge we have been talking about for months as these supplies are upon us now. The second step is raising kills and big margins. The third step is increasing forward demand. The last step will be declining placements patterns into the spring and summer. As you will read in the words ahead all of these things are happening.

Beef prices dropped $10 into the middle of the month before jumping back to new highs for the year to start the month of May as seasonal demand is in full swing and consumer demand is coming through much better than expected. Prices are running towards last year levels despite the larger production paces we are seeing. The challenge for demand will be the 5% increase in supply from here that will remain constant through May, June, and July. Testing capacity constraints and the ability of our labor force to keep up will be the determining factor for cattle prices this summer. Our current uptick in prices into May is expected to be the highs for the summer in and around the $130 live and $235 area in beef over the coming weeks. From there prices will erode into July with the decline in price dictated by the degree of continued retail demand, our pace of exports and our ability to run the plants full out. Exports will be the key discussions with China tariffs being re-negotiated with US officials this week.

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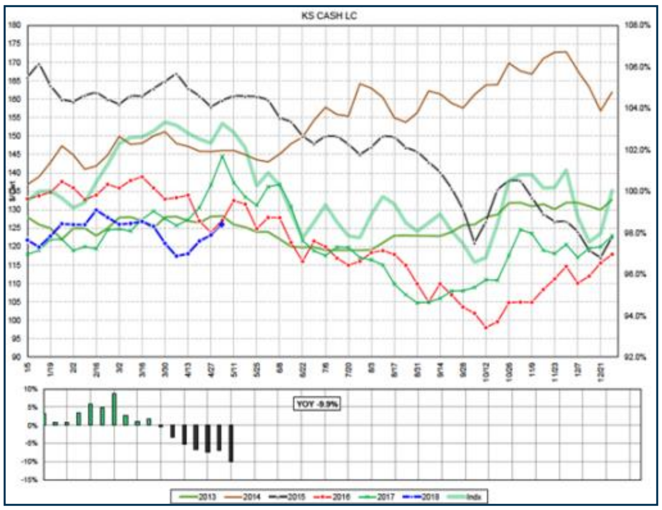
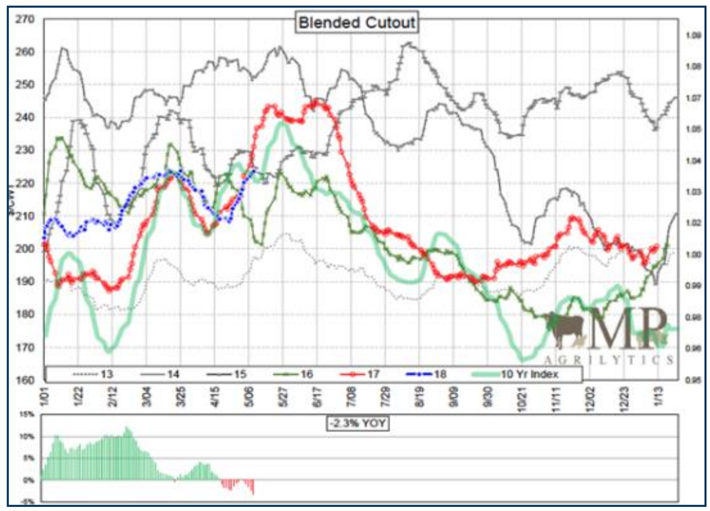
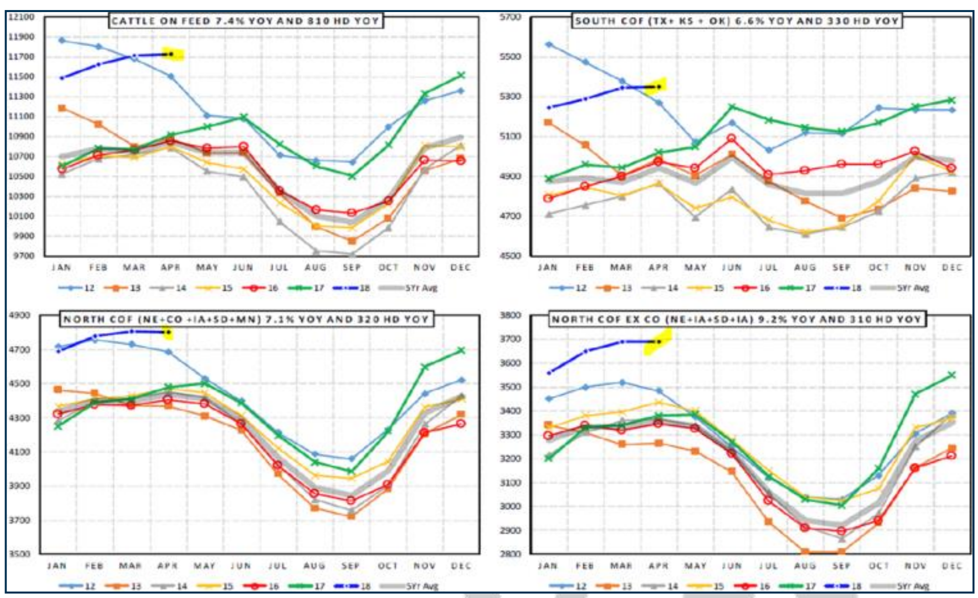
Packer margins contracted slightly in April but will move higher seasonally in May and June. Margins are sitting at $150/hd if you are a spot driven guy and $250/hd if you bought cattle ahead like some did over the past few weeks. Margins are expected to swell to $300 to $350/hd in May and June.





Exports have remained stronger than expected with March trade data still running 14% over a year ago. April weekly data has declined a bit but running steady with March's averages overall. A sharply higher USD is expected to weaken interest through the summer before fall demand can pick up again. Imports are running at -4%. Domestic forward sales were record large through late March and all of April as retailers dug in and bought May and June inventory aggressively. This is good for early summer retail features and should continue to show us strong demand figures in our data.

USDA posted the April 1st Total Cattle On Feed during late April at +8% compared to a year ago. Placements stopped dead in their tracks from the past several months of strong drought induced placements, posting March placements at -9%. Because placements last year were so large last year this -9% for March was still the 3rd largest in history and didn't drop total Cattle On Feed supplies at all in total from March 1st to April 1st. April placements are expected to be -15%. Rains have finally hit the southern plains so FC demand for outside feedyards will increase and placement patterns should drop for a few months through the summer. This is our September through December supply. If April and May placements are -15% we will pull total Cattle On Feed supplies down from 8% over a year ago to only 2% over a year ago by July 1st.



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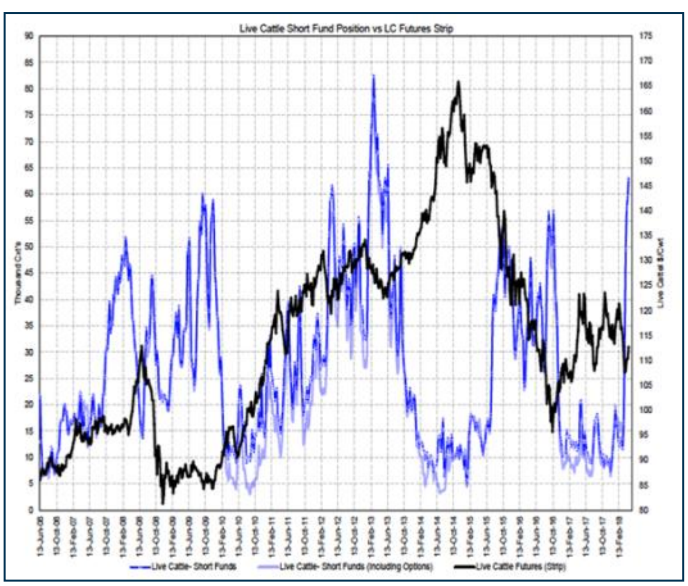
When we started talking about all these cattle back in November and into February of this year we said the market needed to move much lower to create demand. **It did.** We also said the spreads needed to collapse to encourage carrying some cattle out of August. **They did.** We also said basis needed to strengthen a lot to encourage the marketing ahead of summer supplies, this has happened but the total supplies being pulled are not enough to our liking so far. We also said we needed to consistently kill 660k hd a week for 12 weeks. Well, we have yet to do that and our pace into May was subpar to say the least. So while we have started down a good path we still have a long "row to hoe" to give you that all clear. As a result, the seasonal lows for cash are **NOT** in and prices are merely hunting for their spring highs as you read these words. All in all, the things we a changing gives us enough to shift our model up for summer lows. However, before we peg data points this early in the game we need to see how we handle the June and July supplies. This only feels like the 2nd inning of a 9 inning game. With the placements falling like they are we would think that the deferred contracts will be hard pressed to break much lower than this $110 area. The bigger issue in the market over all is the insanely wide basis and how this will play out with cash this week running $126-$128 and the board at $107 in June and $114 in December.

We will look for an early seasonal low in cash this year vs a fall low and will likely hunt for that into June or early July most likely. We are now down to levels that we decided to flip our positions from big shorts to minor bulls with covered puts as a trade into the pending basis collapse and strong seasonal demand into May. After mid-May we will likely re-engage bear mode again while always looking for creative ways to be long the back months.

Index and trend following funds will chalk up 2018 as their biggest debacle ever in cattle. They bought roughly 110,000 contracts from $109 to $128 talking little supply and inflation head winds. After funds went "all-in" in as of March 1st they began liquidating them all from $113 to $97. Index's sold out of 30,000 contracts from 140,000 down to 110,000 contracts. Long funds sold out of 30,000 contracts while short funds increased their positions by 50,000 from 10,000 short to 60,000 short. Commercials bought every one.



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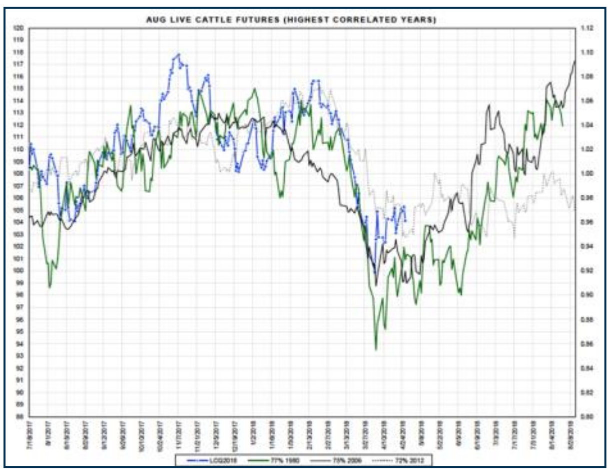
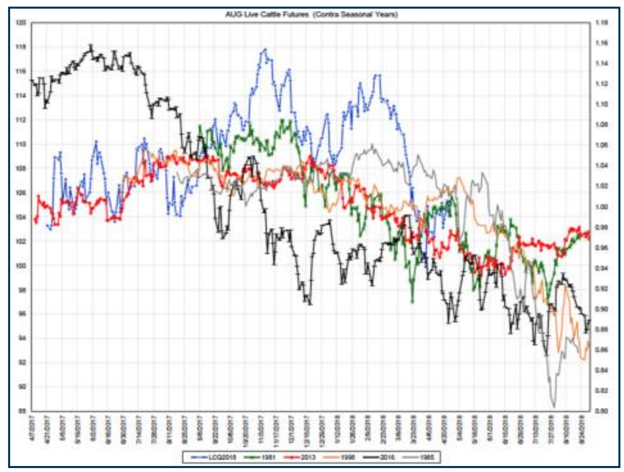
Volatility will continue to be excessive so we will continue to be big traders of options to limit our overall risk exposures relative to our positions. We are looking for reasons to be long the August, October, and December contracts but waiting for more data to clarify our risk parameters as well as the seasonal lows in cash to play out. We are NOT comfortable being long volatility in the June as when we were long volatility for the break. However, the volatility is very cheap in the back months at 16% so we will focus more and more attention back there as the summer evolves. We see that as a very good long-term focus.

On Feed supplies have peaked so any retest of our lows or new lows will be short lived. This is where you will find us increasing our risk parameters later this summer if things come together. However, with record large supplies on feed in the north we will find feeders struggling at times with marketings if they do not stay in front of things.





Regards,

Scott Shepard

May 7, 2018

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

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