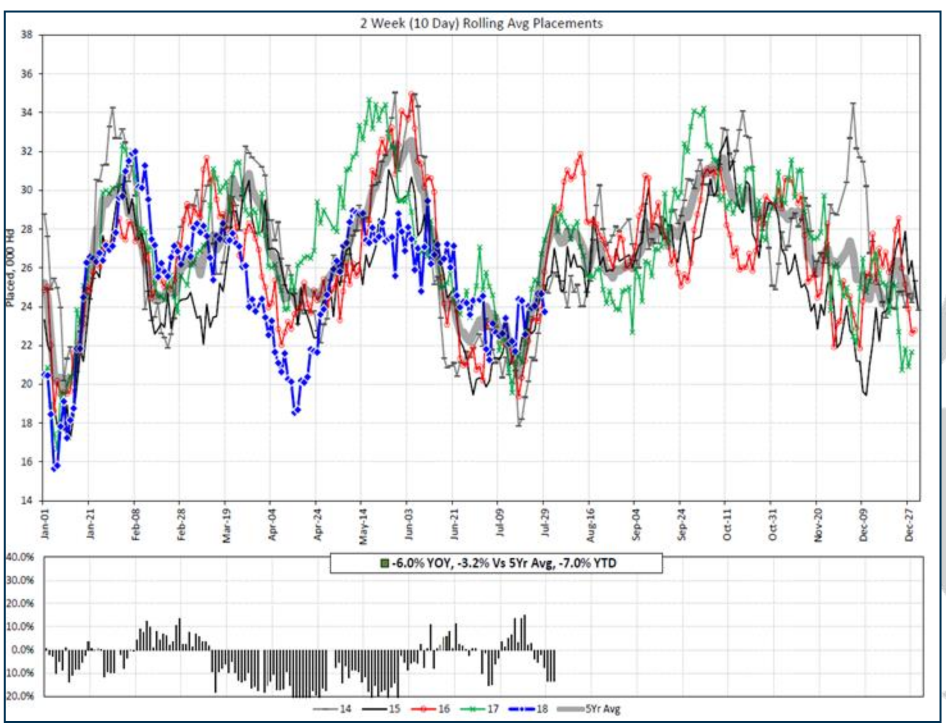
July 2018 Monthly Commentary

	Week Ending 1-Aug		Week Ending 1-Jun
Kansas Cash Trade	111.50	3.50	108.00
Blended Beef Price	201.28	-5.32	206.60
August	108.62	1.90	106.72

Cash cattle prices started the month at $108 but found support up to $112 coming from contra seasonally tighter supplies amid continued very strong beef demand. Food service volumes seem to be the strongest they have ever been as the economy surges and people are eating out more while retailers seem to be happy with current prices and moving volume. Exports continue to be strong but backing off a bit from their all-time record high volumes of this past spring and summer. Packer margins eroded as beef prices seasonally fell from their inelastic demand levels that are usually supportive into the early summer. Record packer margins from the summer at $300-$400/hd are now hovering around $150/hd, still very strong. In response to the margin crunch packers pulled harvest rates down about 3% or 15k hd to stem the decline. This has allowed cattle prices to come back down towards $110 and also stopped the slide in beef prices. Feeding margins collapsed which is telling cattlemen to hold cattle off the market today and schedule them for later this fall. This will cap advances later this summer as we look into October as these cattle become market ready. Placement patterns continue to show that there are some cattle into the fall but much less from there into the early part of 2019. This is expected to be very supportive to prices especially if demand continues to be as strong as it is today. World Trade wars continue to be the HOT TOPIC for speculative positons and dominating headline news and emotions. This later conversation has pulled our risk back to what is still bullish for August expiration but defensive going out to October. However, when looking at the prices of the December contract as it relates to the spring and summer of 2019 those spread differentials seem grossly mispriced. This is being created by the desire of blind index roll from December back into the spring and summer months. Based on S&D models of pure supply there is most likely an 8% skew in production that we will see which implies that fundamental value of those months should be approximately $10 not $1 like we are seeing today. These two ideas, the August expiration and the back spreads, will be our focus for the coming months.



Placement patterns we discussed above are shown here. As you see, the sharp decline in placements from March through June will be coming at the market this fall and winter. While "some" cattle have been pushed from July into the early fall I want to show you that this is filling in a hole to some degree rather than rolling head count on top of larger placements. This was a very large decline in placements, and we can't forget that. While we should be expecting some increased placements coming at the market this fall these will affect next spring marketings not the winter. That is why we like the Dec, Feb and April vs the June or August on spreads in the coming 120 days.

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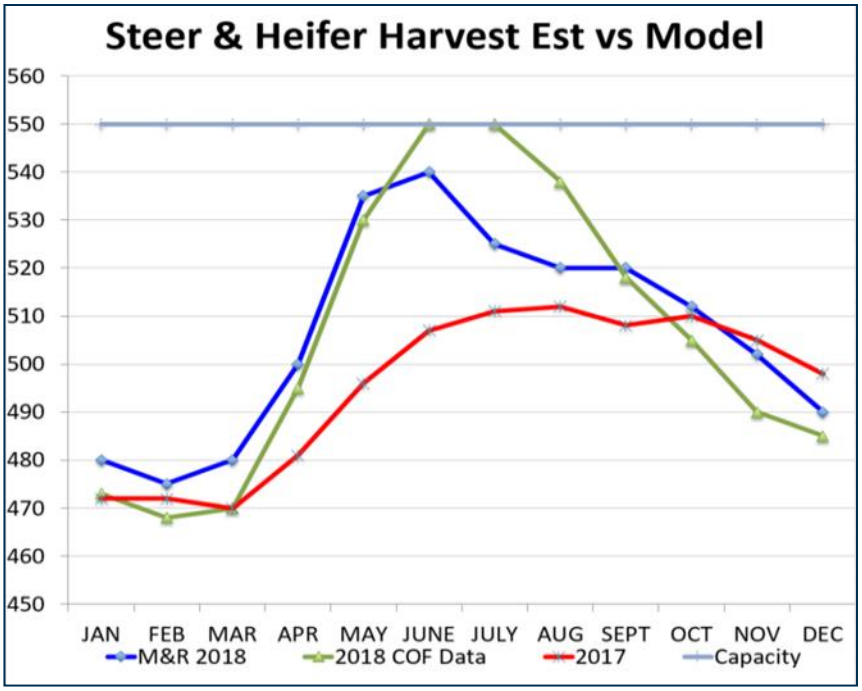
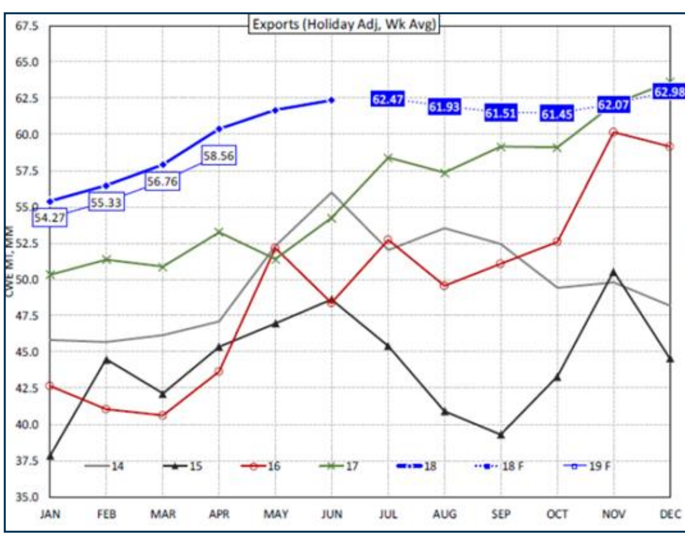
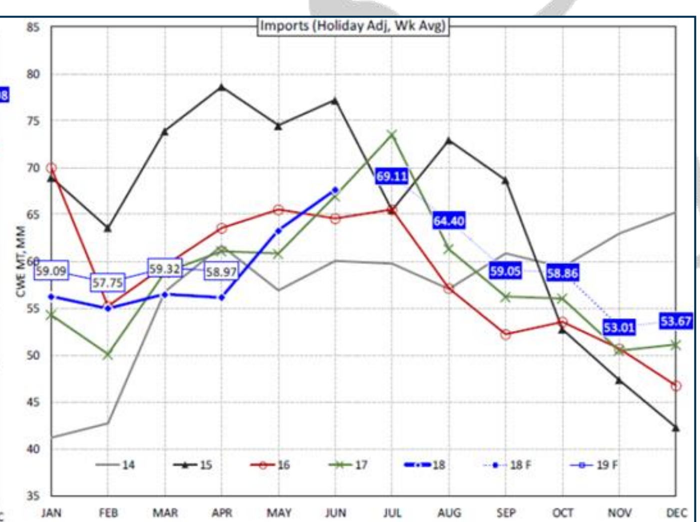


After you take the net trade flows looking at total steer and heifer harvest rates you can see we should see less coming at us into the coming months. The only thing to chew through yet is the cattle we have clearly carried from July and Aug into September and October. But after that supplies should tighten and prices could increase. Next month we will show what next spring and summer looks like but suffice to say we will be talking to you about capacity issues once again.

Net trade flows will be very important to the pricing of this market going into the fall and winter. As you can see from the charts below the export demand we have is expected to continue but what should help us a lot is the declining imports that should follow in the coming months.

It still seems like to us that cash prices have bottomed for the summer but want desperately to retest those lows this fall. However, because demand is so strong packers are having a hard time cutting kills back in order to make this happen. We have moved some cattle out of July and August into September and October and weights are going up which is bearish, but demand seems to be buying the dips for now and preventing a collapse. This all adds up to a choppy market perhaps over the coming weeks and months. Once these cattle are either scheduled or dead, then higher prices will follow after that, which should be the futures markets job now. That and how strong this holiday season demand will be for ribs and tenders, which I am going to have to assume is going to very good considering the pace of the economy today. Remember rib demand around the holidays is PIECE COUNT not TONAGE COUNT. There is a difference. Placement patterns are showing us a gap between current on feed supplies and the cattle that have been placed thus far. Once we get through these cattle here today and into the fall.





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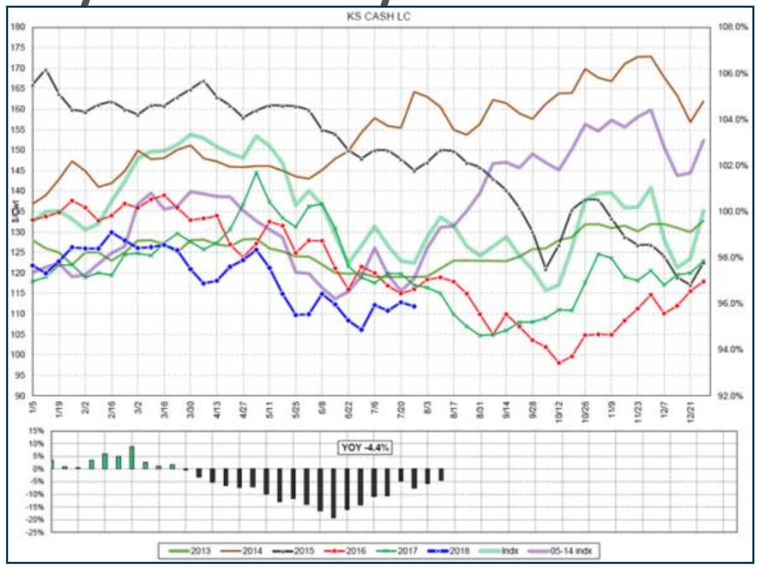

We had a target for this rally of $118 and we got up to only $114 before packers cut kills to stem the tide. Prices are expected to retest our highs as we trade into August. However, over $116 might be tough to hold. Bull spreads should work however, as fears of going down to $105 hold October from moving too much over $112. As strong as demand is and tight as supplies should be after this fall $106 should be a floor for trade. Upside prices however will be determined by demand and the packer's margin desires. The model can get prices up to $125 and a floor of $115. While this remains to be a hopeful target we might not see that until later this year. Once holiday demand takes over and all the fall cattle are harvested.

The thing that REALLY intrigues me is all the TARIFF talks. One thing is for certain, we are not in a TRADE WAR as much as we are in HARD NEGOIATIONS from two bully's that must both win. Fear of false factors is always bullish and we are certainly into the deep waters of fear now. GDP growth of 4% or more is HUGE vs the rounding error of a year of tariff related costs. As an example, the Mexican deal re-doing NAFTA sounds like it is completed and will be announced very soon. Certainly by the middle of September at the latest. The issues with the EU are over too and they even gave us a much better deal on US beef exports (which has yet to be made public). All that is left is the two bully's in President Trump and President Xi to figure out a way that both can claim victory and move on. In the mean time the false reports in the news and headlines repeating old information will continue but within the reality of the industry China is actively working to procure US meat using other countries (Australia and Mexico as example) to keep themselves in control. I'm confident that when we look back President Trump will have done more for the beef industry than 30 years of wasted checkoff dollars has done from NCBA or any other of the US trade groups. My point is that the gut of these issues has been coming at us since March and should be behind us. As an example of this, Trump just announced this past week that the $200 mln in goods to be tariffed at 10% are going to go to 25% but the comment and implementation for this is "extended" out to September 5th. What is important to understand from the REALITY of the trade is that all of the REAL effects on the flow of these items has already been seen by the first wave of this mess. So raising the rate won't affect anything at all today forward. The only affect that is left once you have stopped buying is to agree to terms and start buying again. They can't buy less than the March through June volume as it has effectively been zero. Current export rates find roughly 11% of US beef exports moving through Hong Kong but only 4% of the broilers (chicken) and only 1% of pork. The big question I'm asking is that this is only a matter of time now not tonnage as that ship has sailed. We are seeing hints of this in pork exports and will be watching attentively for more data. What does that all mean for trading? Well it means the debacle that has been hogs will be searching for a bottom and we will be diligently paying attention ourselves. It also means that even more beef and flow than was has been cautiously flowing to date.

The big funds that are playing these tariffs are still long equities/stocks and short commodities like they have for the past six months. The index funds are done selling and starting to re-engage the markets as they have been buying over the recent weeks. What is interesting about this category is they seem to have fired 30% of their OTC swaps execution agents for terrible order execution (skimming swap dollars) and are now working with new agents. This was them selling in April and May and now re-engaging over the past month. Some indexes are even rolling already from the fall into 2019 for a much longer term focus, with the goal of reducing the frequency of roll risks. Commercials who had been

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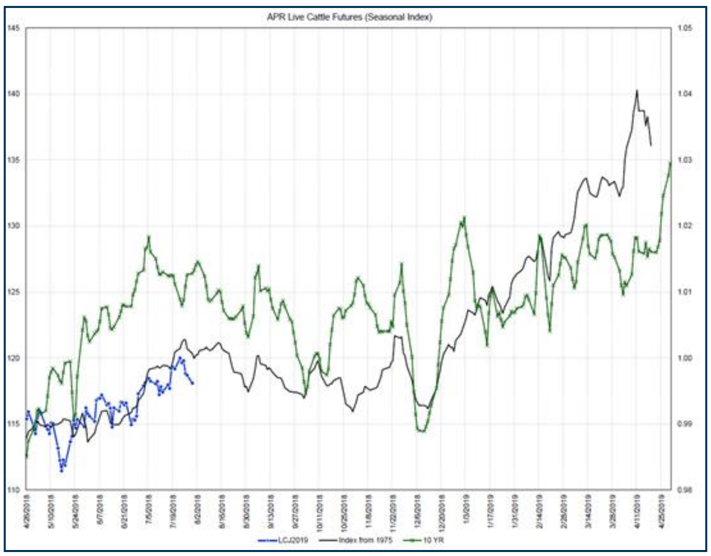
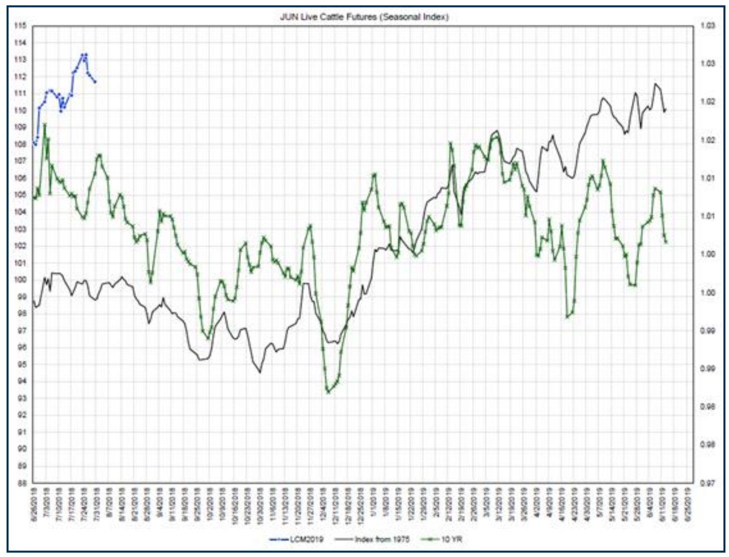
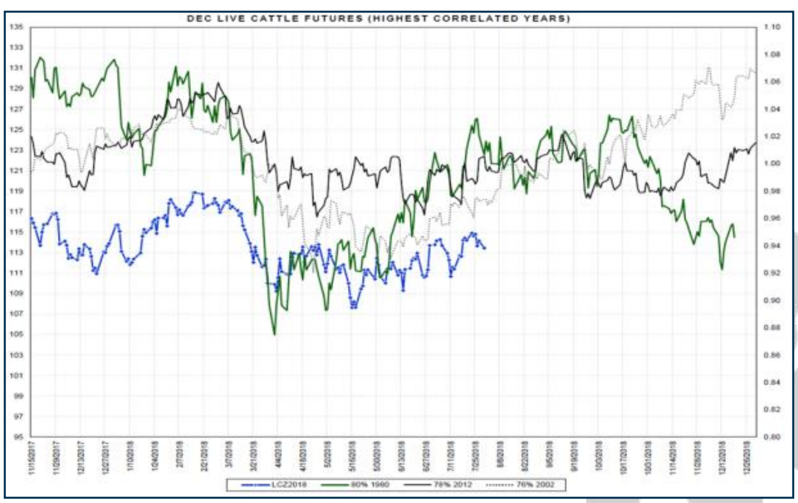
long have released most all their bullish plans and are trying to actively break the market. The rocking back and forth of these three players is creating most of our volatility while the HFT's remain very active racing anyone and everyone they can see. Headline news continues to distort prices and will hopefully be to our advantage over the coming weeks and there is significant increase in report(er)s these days that have NO IDEA what they are talking about let alone writing about. Cash is king and we will continue to focus on that.







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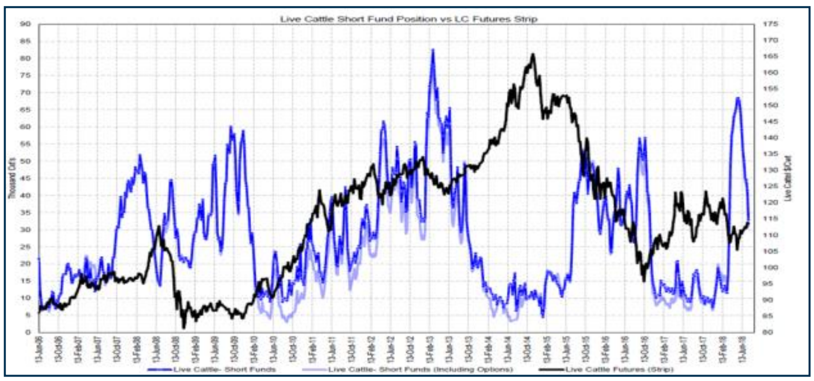

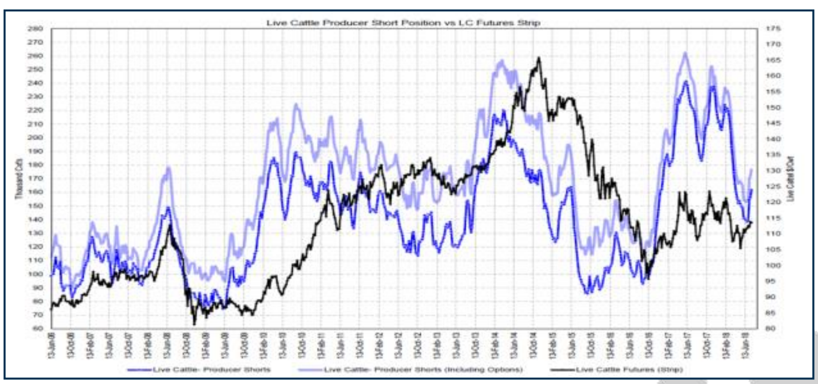

Thank you to our friends at MP Agrilytics for their data and charts.

Regards,

Scott Shepard

August 3, 2018