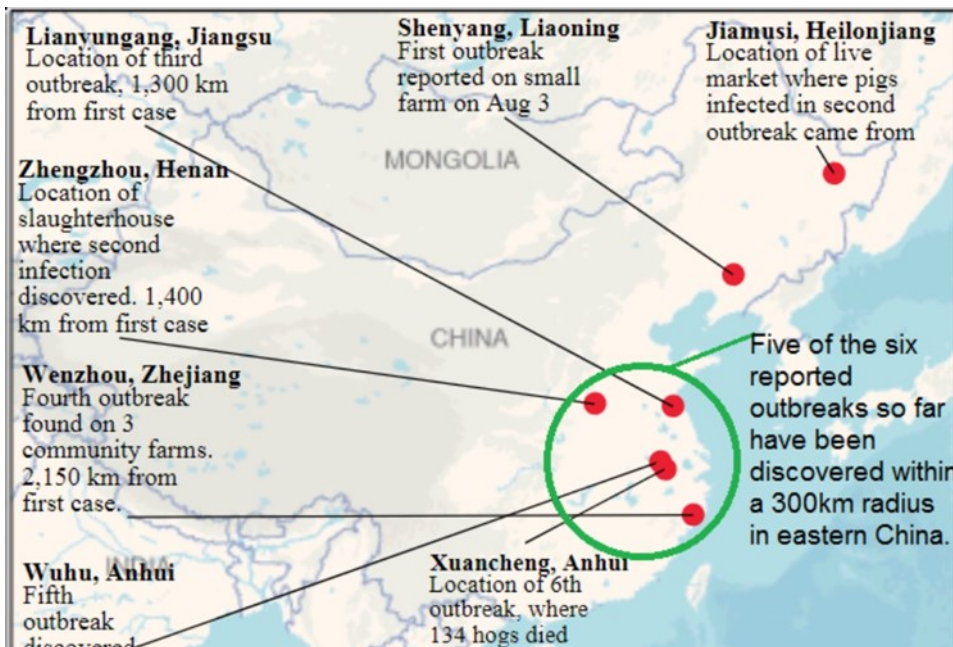


August 2018 Monthly Commentary

Cash cattle prices started the month at \$112 but declined to \$107 by the end of the month. Despite very strong consumer demand and adequate cattle supplies, packers chose to reduce harvest schedules which pushed packer margins to all-time record levels for this period. Beef prices were +\$4 for the month compared to the \$5 decline in cattle prices. Basis is starting its seasonal migration from strong to weak prices as noted by futures only being -\$1.50 compared to the -\$5 in cash trade. Seasonally beef prices are expected to decline roughly \$10/cwt for the first part of September before starting their seasonal climb higher into the winter. Peak supplies are behind the market having been seen this past June and July and again here in early September. Beyond this early September time frame supplies are expected to contract into the spring before we can see similar harvest rates again. Because of this, cash prices are expected to be bottoming right now. Demand has been and is expected to continue being nothing short of exceptional. Domestic demand and export data for all beef categories are very strong. Added demand may come from a resolution of the aggressive trade negotiations the markets are seeing from the Trump Administration as we look into the 4th quarter and certainly into 2019. China, Mexico and the EU are the countries mostly watched at this time. Over the holiday weekend, Argentina has effectively added approximately 10% more cost to their beef exports with a tax levied now through 2020. These are all things that should continue to be supportive of US exports as well forecasted forward prices.

	Week Ending 31-Aug	Week Ending 27-Jul	
Kansas Cash Trade	107.00	-5.00	112.00
Blended Beef Price	206.06	3.67	202.39
October Futures	108.77	-1.70	110.47



The recent outbreak of African Swine Fever (ASF) in China is a major concern for trade. ASF is carried by wild boars (that show no symptoms), ticks, feces and pork food waste. ASF is typically transmitted by contact. No human health risk exists today. There is no vaccine so the only solution is to cull the herd and do not restock for a period of time to prove a quarantine effectiveness. To give you a reference, China has a hog herd of roughly 430 mln head. However, only 15% of these are commercial oriented production facilities of 1,000 hd or more while 55% of the production are controlled by smaller operations of 1,000 hd or less. The remaining 30% come from backyard farms of 50 head or less. Since ASF has

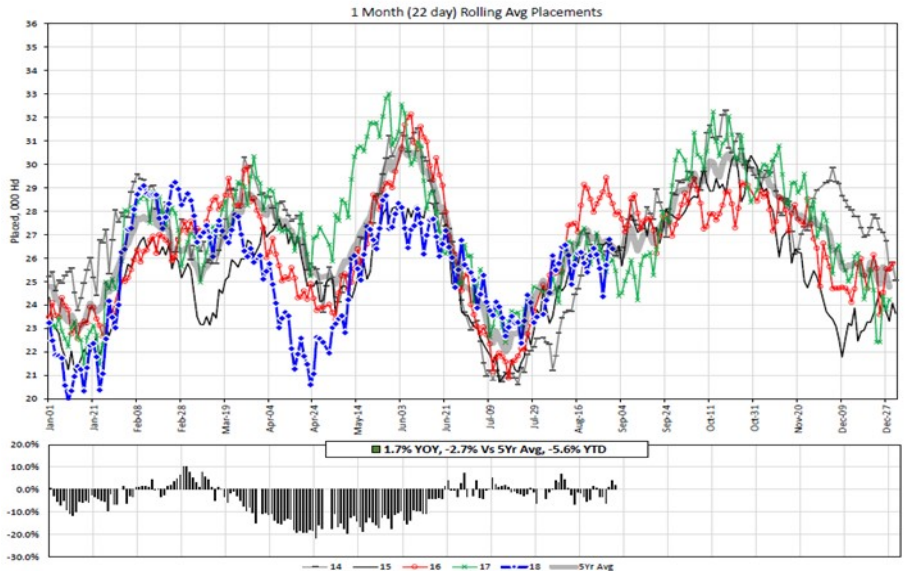
“no vaccine” when you factor in the nature of the backyard production and transportation methods combine with the lack of sanitary conditions it means that the disease is very easily spread and most likely rampant at this time. If we assume a 10% contamination rate for ALL BACKYARD farms and transportation methods that means (430 mln hd * 30% backyards * 10% infection rate) 13 mln head are affected for just that sector of the business. As you can see the reported numbers from the China Ag Ministry at 38,000 head are GROSSLY unreported. By comparison this 13 mln hd guess-timate would be 20% of the US’ available 67 mln hd market hog inventory.



August 2018 Monthly Commentary

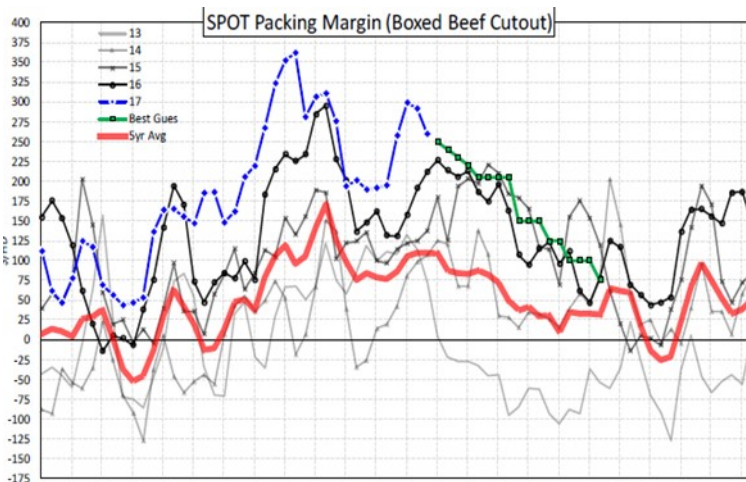
Since not placing cattle through all of March, April, May and June we have yet to appreciably put cattle back into an over capacity production level. As you can see by the chart, the pace of placements through July and August has been modest at best. While matching a year ago we have to remember demand is rising so we need more supply just to keep up, anything less let alone below a year ago will greatly affect pricing and trade. Recent placement patterns have found and aggressive placement of calves (light weight feeder cattle) into the mix while yearling placements (heavy weight feeder cattle) have been lacking. As well these increased placements of calves is expected to result

in a much tighter supply of yearling cattle this fall. This will reduce the spring supply of cattle leaving just the calves as your supply of choice. This is usually a bullish influence for trade when this happens. We see the supplies tightening from October through January where supplies will increase a bit into February before the spring demand kicks in. Calves would seem to be plentiful for the summer at this time. Hence why we like the December vs the summer months on spreads in the coming 120 days. The fun game that we will play is that October cattle futures and cash trade will QUICKLY become the cheapest feeder cattle supplies in all of the country and should ask many feeders why they are giving the packer \$300/hd subsidy to kill their cattle when if they just said no they could get \$120 not \$105. Especially when October gets to a \$6 discount to the December.



Packer margins are the largest ever for this period. Simple math: a fall cutout value low at \$200 and \$100 margin means \$118 cash cattle. While a \$190 cutout and \$100 margin means \$112 cash cattle. Best case scenario is a \$220 cutout peak this winter and a \$100 margin that implies \$130 cash cattle trade. All things that seem to imply a limited

downside for futures and cash trade as we look into the coming 3-6 months of trade.



Cash cattle trade bottomed this week in early September last year and while this year may not be on the perfect track with 2017, it seems to be trending similarly just the same. If early September lows come into play around this \$105 area like we forecast the upcoming winter, demand rally should yield prices pretty close to \$120 as we discussed above in the packer margin calculations. Keep in mind that in 2016 demand was very soft compared with very strong here in 2018. This demand pull compares slaughter rates in 2016 that struggled to remain over 600,000 hd while so far in 2018 we are demanding 630,000+ rates. This demand should add up to summer lows vs fall lows in the markets

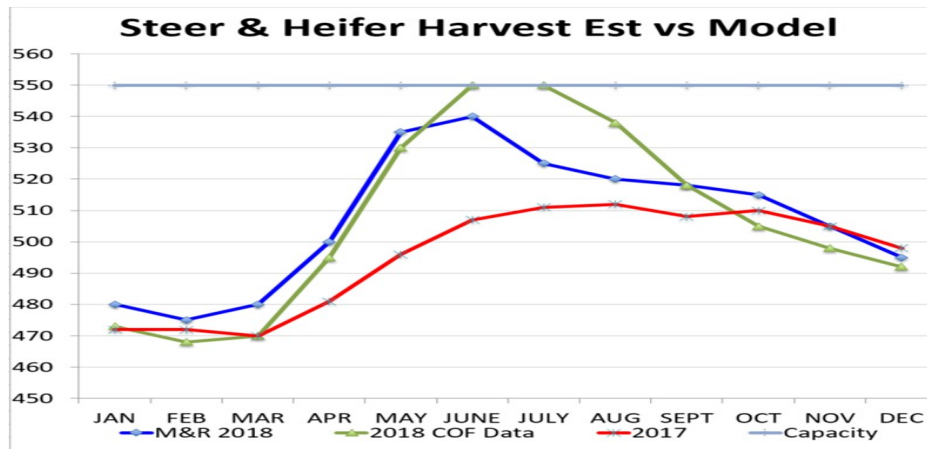
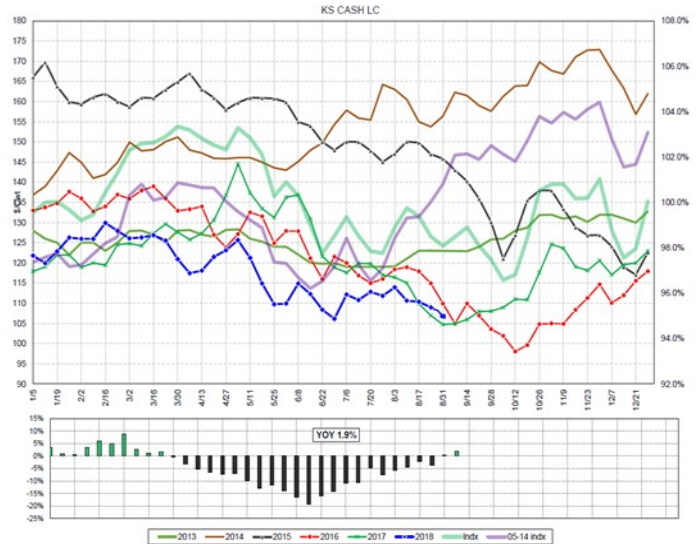


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August 2018 Monthly Commentary

We are expecting that the market will break out to the upside from these recent consolidation patterns we have been in for months now. A rally to over \$120 seems clear for the upcoming 3-6 months with packer margins dictated the degree of upside. As strong as demand is and tight as supplies should be after this fall \$105 should be a floor for trade. The model can get prices up to \$130 and a floor of \$112 beyond these late summer lows at \$105.

The degree that USDA projected supplies were missed so badly this summer less the cattle that were moved from July into September has us calculating how much USDA might have over counted the total Cattle On Feed supplies in the US at this time. If we are correct in our guesses we should start to see USDA increase their "other disappearance" (OD) category on every monthly report here forward to account for the "missing" supply. As a note of confidence, a sustained move over \$112 in the futures and cash will give the funds a renewed aggressive focus for long cattle positions.



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

Regards,

Scott Shepard
September 4, 2018

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