September 2018 Monthly Commentary

Cash cattle prices started the month at $107 and jumped to $111 by the end of the month as consumer demand remains strong. Packer margins eroded as seasonal expectations implied but still remain very strong. Beef prices eroded as they normally do seasonally, likely marking a seasonal low in prices in early October. Futures prices rallied with cash cattle trade and approaching their contract highs across the curve in the December through all the 2019 contracts. Fund buying remained strong throughout the month while producer short hedging increased. Index funds continue to roll longs from October and December back into the 2019 contracts despite placement patterns picking up seasonally for during August, September and October.

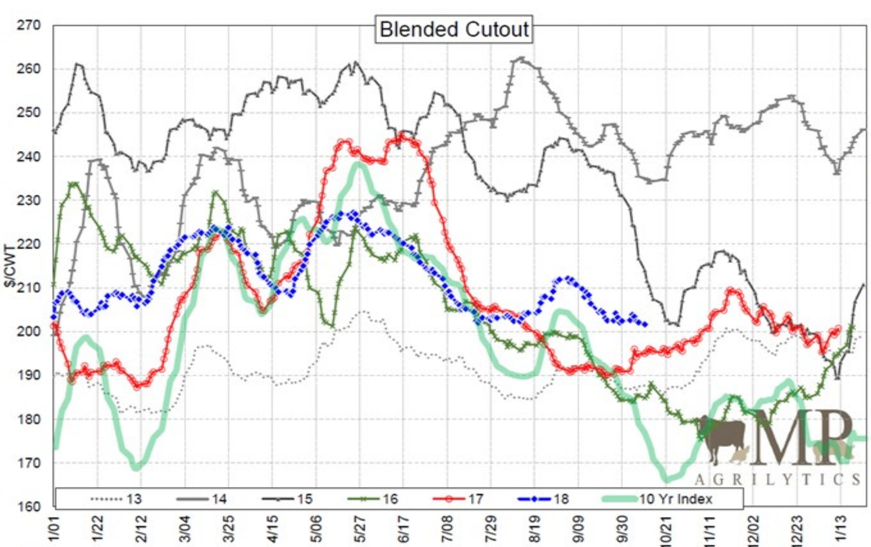
	Week Ending 29-Sep		Week Ending 31-Aug
Kansas Cash Trade	111.00	4.00	107.00
Blended Beef Price	199.70	-6.36	206.06
December Futures	118.85	5.33	113.52

In our last report we said that the board already had the seasonal $10 drop in beef prices priced into it and for the month we dropped about $7. Now we should see the seasonal bottom in prices as we look into smaller harvestable supplies over the coming 8 weeks as compared to the prior 6 weeks. Beef prices are expected to be back at $215 by early November. The following tells us given beef prices and said packer margin where cattle prices will be at:

$200 beef today $50 margin $118 cattle, $100 margin $114 cattle, $150 margin $112 cattle.

$215 beef in the future $50 margin $128, $100 margin $124 cattle, $150 margin $120 cattle

Based on this you can see we are bullish the market but considering trade is so whippy these days and seasonally tendency tell is to be careful in early October, especially after a run like this to contract highs, we are more prone to buy a dip. Any correction off these highs we will certainly re-engage the trade. Clearly cash is going up but will the board go up with cash from $119 or $115 instead is our question yet to be answered? Until we know we will wait for the latter.



Consumer demand remains VERY strong with retail channels and quick service restaurants (QSR) and fast casual chains saying that beef demand is very good if not the best they have seen in years. It is so good that some of the biggest QSRs are expected to continue expanding their offering of beef as well as bacon products (reducing chicken). This is expected to continue to be supportive to prices into 2019 despite stronger placement patterns. As an example we can have 4% more production in 2019 and still have cattle prices that are supportive of steady to stronger levels vs what we found them to be in 2018.

Weather is something we are watching like a hawk. It has been very dry in the south which has rushed supplies into the feed yards in the recent months for much lighter weight feeders which will provide two results for the trade. One- it will confuse the layman (funds) that will think these cattle will be coming out in 6 months when in fact they will take closer to 7-9 months. Another issue it will cause is that if winter weather is poor it can have an effect of creating a void in supply this spring and push these cattle further into the summer. Conditions in the north are and have been very wet all summer and are going to get MUCH worse in early October. As a VERY strong rainy pattern will be seen throughout

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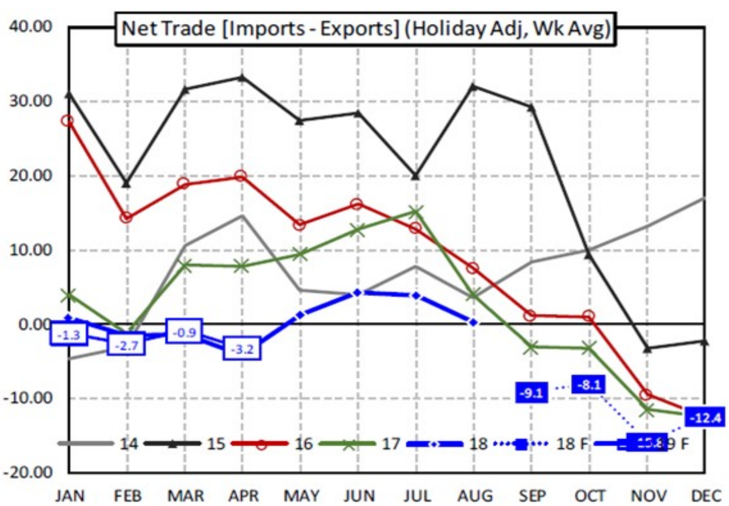
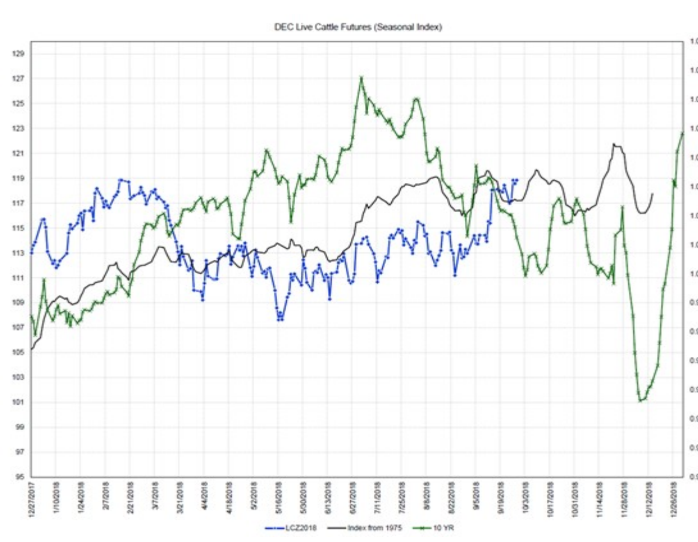
Kansas, Nebraska, and Iowa from October 4th through the 10th. If weather continues to be wet into the fall and transitions into winter it will be very bad for cattle performance. This will force seasonal weight gain to erode and even decline more than expected as we begin the winter.

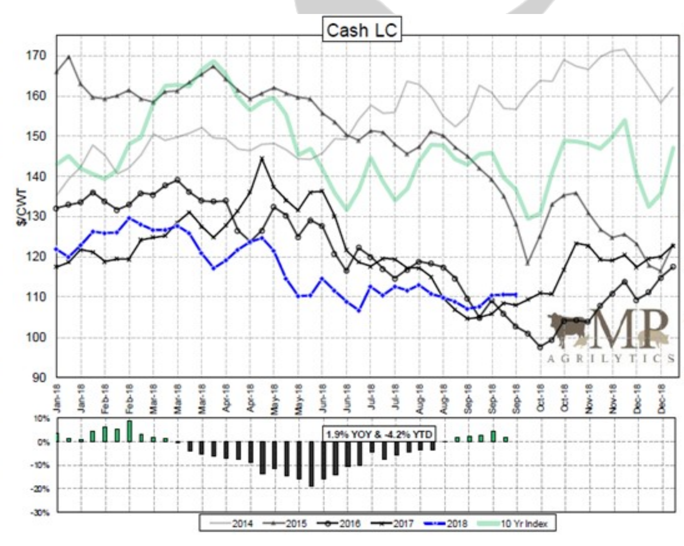
Exports have remained very strong despite the trade wars that the Trump administration has created. NAFTA looks like it has been re-negotiated as of the end of September which will aid in decreasing uncertainty surrounding this case in specific and perhaps all the trade to just focus on China here forward. It's interesting that China is relaxing import taxes from their favored nations while continuing to fight with the US. This will mean that the black market for beef exports can grow if they decide, as an example, to buy more US beef from Japan, Korea, Taiwan, Hong Kong, Vietnam or even Mexico now that they are fixed. We will start to watch the effect from the dry weather in Australia that has increased harvest rates over the past 6 months. As these supplies moderate, less Australian exports are expected to be seen throughout Asia as well into the US. This will create a balance of trade shift in the US from a net importer today to a net exporter as we look into the end of the year.



Since not placing cattle through all of March, April, May and June, we have placed a chunk here in August and September and that pattern should continue into October. These cattle are expected to come out in February while some of them will be coming later in the spring and summer (the lighter ones).

In our last report we said cash prices bottomed in September at $107 and thought we should look to a break out to the upside over $110 in the October and over $114 in the December and that proved to be correct. Early October might hold cash prices still steady as packers pull back on kills and try to encourage the weak marketing hands of the north to deliver cattle to the CME. If this holds prices steady early in the month it can possibly pull the premium futures down and adjust basis slightly. Once this aberration is over and the effects of the CME are behind us or at least public then





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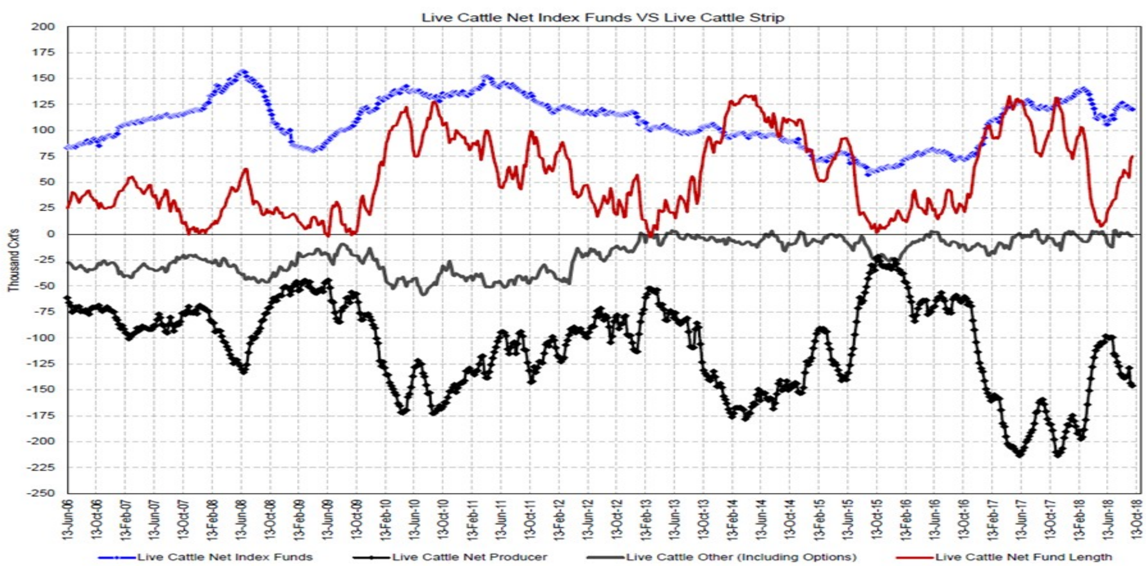
prices should begin to move higher. Cash should be able to get up to $118 or a bit more as beef prices seasonally move higher from mid-October into November. February and April futures should be able to easily touch $128 as we look into this time frame. However, as we mentioned, we have to be wary of a potential dip from current levels.

African Swine Fever (ASF) continues to be a hot button for many industry pundits, macro traders and commercial users. Funds have been actively buying hog futures and talking this disease up for the past two months. As this has occurred, cash hogs prices have moved from $45 up to $64 where they sit today. However, since we have seen so much excessive speculative buying action we need to be keen to watch this. This is because if we find these ASF outbreaks subsiding or if they stop all together, these longs will need more bullish cash news to feed their positions or they will be at risk of a sharp long liquidation sell off. We expect cash prices to peak out into the early part of October and begin a corrective trade as we look into November. As we mentioned in our last write up we missed our shot are getting long for this play so we will focus on owning puts looking for these excessive longs to be run out between now and year end.



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

Regards,

Scott Shepard
October 2, 2018

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