M & R Capital LLC

October 2018 Monthly Commentary

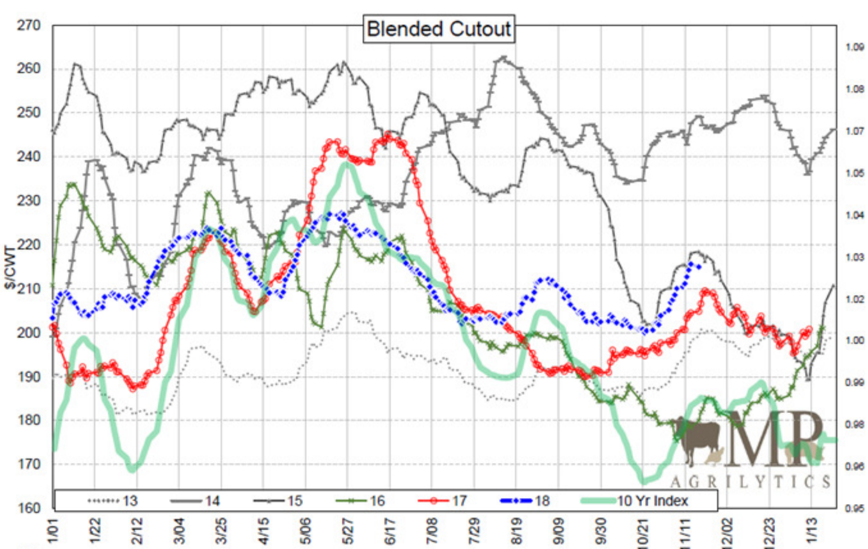
Cash cattle prices started the month at $111 and jumped to $116 by the end of the month as consumer demand remains strong for beef as did packer demand for cattle. Packer margins are record large for this time of year, which means cattle prices are low by comparison to the wholesale price for beef. Beef prices jumped $12 as demand for all items in the carcass (middles meats, trim and grinds as well as end cuts) were strong. Both retail and food service demand, along with exports, remain strong. Futures prices eroded, narrowing basis, as fund long liquidation and index fund long roll pressured trade. Producer short covering and new commercial longs are taking on this selling.

	Week Ending 3-Nov		Week Ending 29-Sep
Kansas Cash Trade	116.00	5.00	111.00
Blended Beef Price	211.69	11.99	199.70
December Futures	117.07	-1.78	118.85

We said in our last report that beef prices would be $215 in early November and they are precisely that. Beef will make a temporary top stalling seasonally in early November before continuing to move higher still into the spring. We don't expect beef prices to erode more than $5 from current levels before moving higher into the spring. Fast food, retail and export demand all continue to be strong and expected to out-pace the rate of placements for 2019. Packer margins are very strong and expected to absorb the potential decline in beef prices over the coming 30 days while cattle supplies will tighten. Steer and Heifer harvests are running at about 500,000 hd a week right now and will be closer to 475 in early 2019 down roughly 5% from last month's pace. February is typically our worst demand period of the year so if there are any concerns about pricing it is here. Other than that $250 should be easily attained this spring as demand rises but supplies are spread out and weights are not increasing. The following tells us, given beef prices and said packer margin, where cattle prices will be:

$200 beef: $50 margin $118 cattle, $100 margin $114 cattle, $150 margin $112 cattle.
$215 beef: $50 margin $128, $100 margin $124 cattle, $150 margin $120 cattle, $200 margin $116 cattle.
$250 beef: $50 margin $148, $150 margin $138 cattle, $200 margin $133 cattle, $300 margin $123 cattle.

These simplistic values for margins and trade will comprise our forecasts for cash cattle prices this spring, a range between $123 and $138. As far as the summer is concerned I am focusing in on a range of $105-$125 for the June and August contracts. But supplies against these contracts won't be totally known until late this year into early next so we will wait to define those more precisely in January. Based on this you can see we are still bullish the market but considering trade is so whippy these days we can still find technical sell offs which we need to be respectful of. The seasonal tendency for prices to be heavy in October should now be behind us with the maximum selling power peaking in the first week in November and diminishing greatly every week from there forward into early 2019. So we are moving into a buy dips mode now. Any correction under $115 should be very good ownership basis the December and under $120 in the April. As well the December spread markets seem to be miss-priced and too cheap, another opportunity to look at especially into the index roll period (early November) which has a tendency to intentionally misprice the market.



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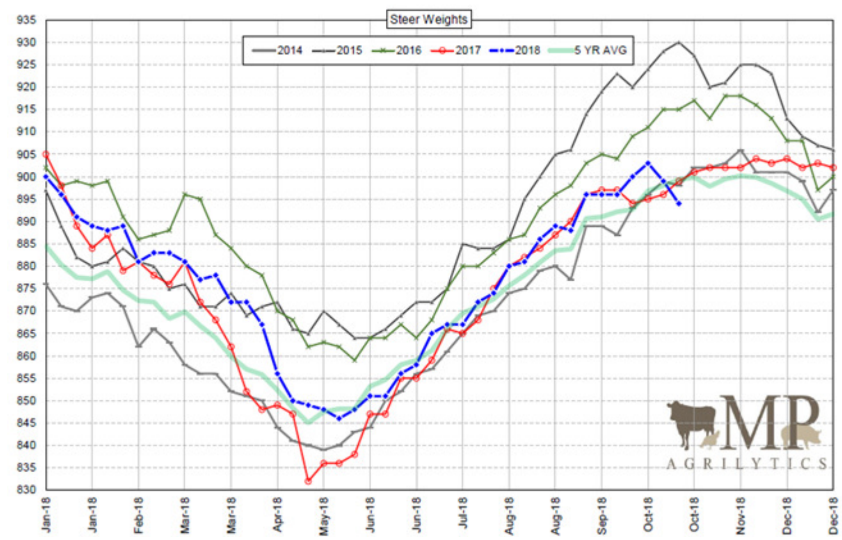
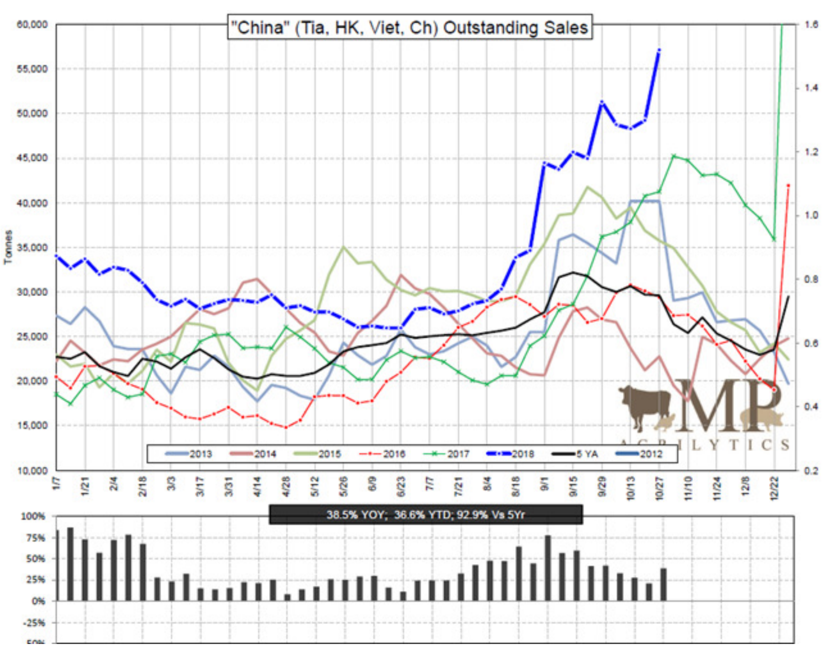
Clearly cash is going up and the board seems to be waiting for funds to sell it or roll out of it before it moves higher, which should be done by the end of this week.

Consumer demand remains very strong with retail channels and quick service restaurants (QSR) and fast casual chains saying that beef demand is some of the best they have seen in years. This is expected to continue to be supportive to prices into 2019 and should out-pace the slightly smaller supply forecasts that are currently placed into feedyards. As an example we can have 2% more production in 2019 and still have cattle prices that are steady to higher levels vs what we found them to be in 2018.



Weather is something we are watching like a hawk. It has been very wet and muddy, which has pulled weights down contra-seasonally. As you can see, weights can work themselves out of this pattern as feedyards clean up this mess in early November. This can cause a retest of this year's highs from a few weeks ago, but for all intents and purposes, weights have likely topped for the year. When you compare weights today to an expected trend we are 20-23 lbs off trend today. Weights are very important as they can decrease or increase production by 0.50% to as much as 2.0% based on what they are doing. Winter will be starting next week in the plains and when this happens after a wet fall, it typically is a pattern that forces weights down as yards can't keep up with the wet and cold conditions. This forces the cattle to use feed for energy to move and warmth instead of conversion into meat/muscle.



Exports have remained very strong despite the trade wars that the Trump administration has created. NAFTA is now agreed to and Asia has been very strong. As a matter of fact China has gone unnoticed by many "talkers" in the analyst world including USDA that simply believe cattle prices are topping now at $115 and going back to $100. But when you look at the data you will find exports to China are just huge. Almost twice as big as they were this spring. Outstanding sales are currently over 55,000 metric tons compared to a peak at 30,000 MT back in the fall of 2016 and around 42,000 MT in the fall of 2017. Export sales can erode seasonally in to the end of the year as countries battle tariff quotes and inventory constraints. However, if this recent demand pattern continues, 2019 is expected to be robust.

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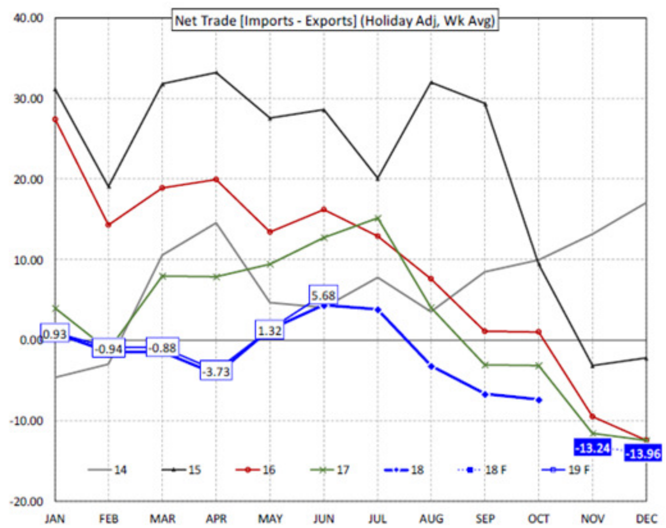
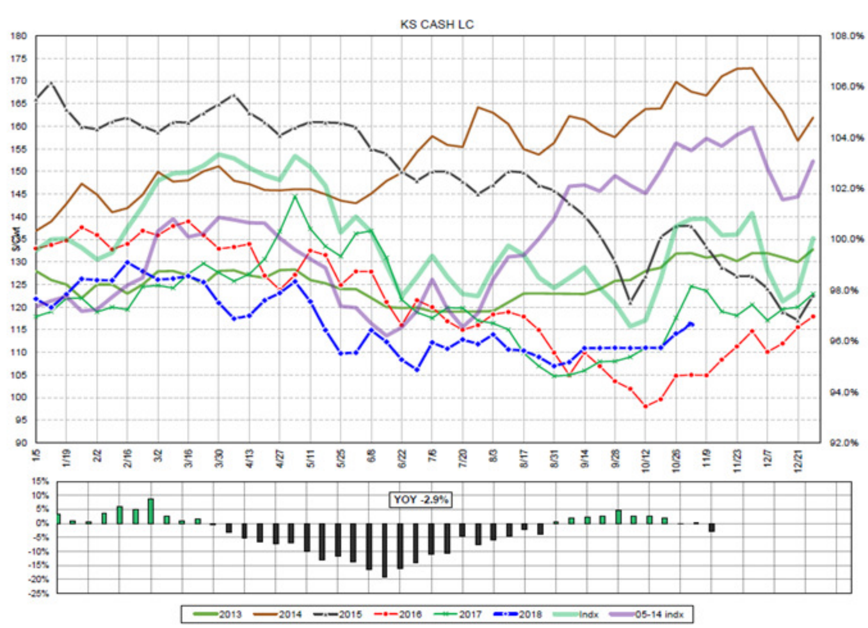


What is most interesting to me is that China has been relaxing import taxes from their favored nations while continuing to fight with the US. This means that the black market for beef exports can grow if they decide, which clearly they have. As well, just this week the US State Department says that the US and China will hold a high-level diplomatic and security dialogue in Washington on Friday, November 9th. A Chinese official said China is willing to push for a solution to China-US economic and trade issues. Australian supplies are expected to begin declining after a year or more of big kills. As these supplies moderate, less Australian exports are expected to be seen throughout Asia as well into the US. This means Imports to the US should keep falling. 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 as well as 2019.

Two reports ago 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 futures and over $114 in the December futures. That happened during September and since then October found itself chopping sideways looking for a correction. As this correction has opened up in early November to start the month cash has moved from $111 to $116 and should remain steady to stronger from here unless packers want to shift to killing 36 hours. But with margins so big that seems like a hard thing to forecast. Cash prices were held at bay in early October as packers pulled back on kills and encouraged the weak marketing hands of the north to deliver cattle to the CME. In effect artificially depressing prices. We think things are tighter for the supplies coming over the next 45 days and should be supportive for prices. Basis typically moves $3 for the December and $7 for the February which has just happened. So our next move from here should be back up to $120 cash and $121 Dec futures and $123 Feb futures after this technical charade of fund rolling is completed. The potential dip we feared and discussed from our past report should now be in the process of completion here shortly as the only thing pressuring trade is the index roll and some weak technical longs stopping out. Beyond this there should not be anything pulling prices down that we can foresee at this time. $114 should be a floor for trade for the remainder of this year.



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ASF continues to be a hot button for many industries pundits, macro traders and commercial users. Funds have been actively buying hog futures (and some buying hogs and selling cattle) and talking this disease up for the past three months now. As this has occurred cash hogs prices have moved from $45 up to $68 but now pulled back to $60 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. That said the true effects of any continued ASF outbreaks will be seen in the later parts of Q1 in 2019 and certainly into all of Q2. As a result we will use any hard sell offs from here to get into long calls or longs in April or June futures.

ASF outbreaks in China continue and we are convinced that it is much worse than the Chinese government is letting the media discuss. 98% of China's herd is under restrictions. 45% resided in ASF defined states and 53% resides in neighboring states. Expect more outbreaks and expect the post mortem to prove to be a large scale outbreak. China has reported 58 outbreaks and roughly 200,000+ pigs having been culled which is about 0.05% of their herd. However, some quick math using the density of the herd controlled by commercial operations vs small producers and we can get this number up to 30,000,000 pigs with relative ease. 30,000,000 head would represent roughly 7% of their total herd, a significant number. To put this in perspective the US has a 67,000,000 head hog supply.

Taking into account the above estimates and making the assumption that the current trade wars between the US and China will be resolved, then US pork prices are expected to surge. Until then this remains a very precarious trade to follow and forecast. As an example, I can get April hogs up to $80 and June up to $100 with ease on the above assumptions coming true. However, if things remain as they are, prices are more like $60 and $80, respectively, by comparison.

ASF Resilience

Item	ASFV survival time
Meat with and without bone and ground meat	105 days
Salted meat	182 days
Cooked meat (minimum of 30 minutes at 70 °C)	0
Dried meat	300 days
Smoked and deboned meat	30 days
Frozen meat	1 000 days
Chilled meat	110 days
Offal	105 days
Skin/Fat (also dried)	300 days
Blood stored at 4 °C	18 months
Faeces at room temperature	11 days
Putrefied blood	15 weeks
Contaminated pig pens	1 month

Source: Beltran-Alcrudo et al., 2017

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

Regards,

Scott Shepard

November 6, 2018

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