IOWA STATE UNIVERSITY
Extension and Outreach

Iowa Farm Outlook

Department of Economics
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Betting on the Come in the Fed Cattle Market

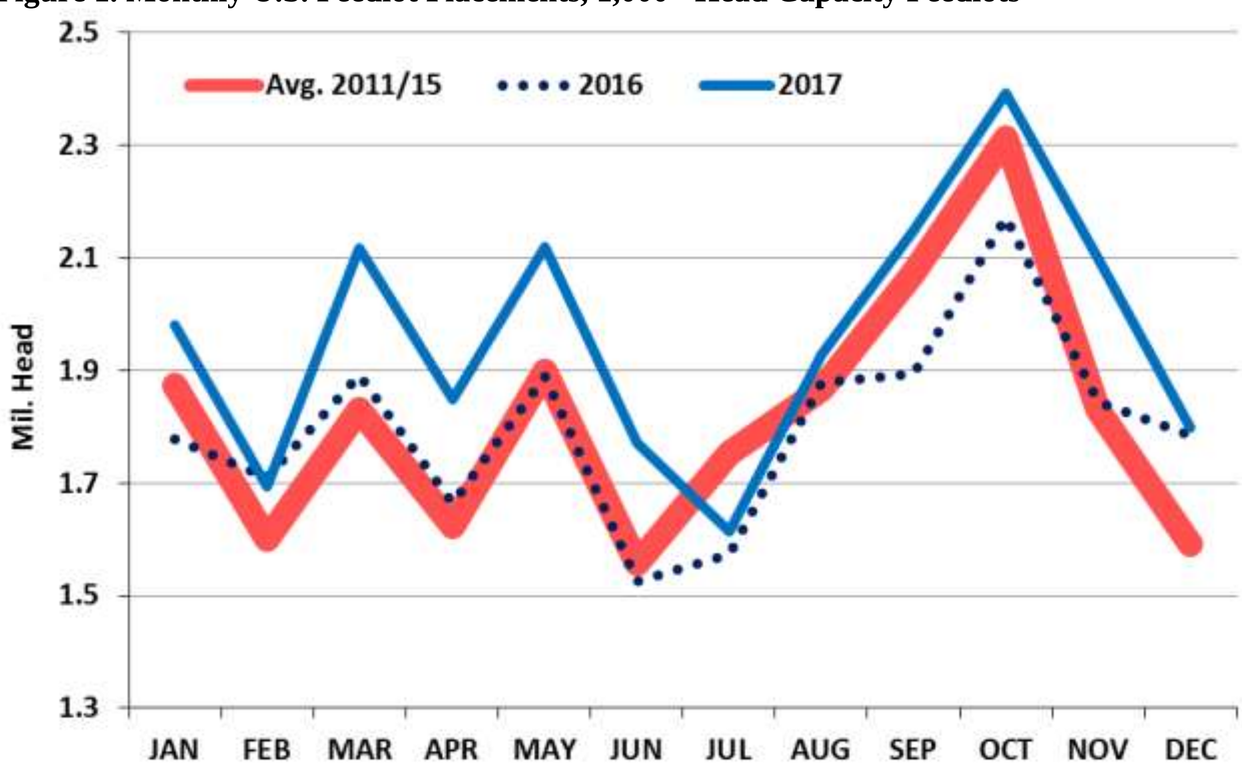
Prices feedlot managers are bidding for feeder cattle suggest that feedlot managers are "betting on the come" in the fed cattle market. "Betting on the come" is derived from a gambling expression and means you don't have what you want or need, now at the moment; but, you are betting, or hoping, you will get what you want or need when the time comes.

Current feeder cattle prices imply feedlot break-evens $121/cwt and up. Summer live cattle futures fall short of that mark. Lighter weight feeders also have feedlot break-evens that cannot be covered against fall 2018 live cattle futures.

After holding between $123 and $131 for February and April 2018 contracts, $116 and $121 for June, and $113 and $118 for August and October, back in November, futures dropped more than $7/cwt on average by mid-January.

In the last four months of USDA Cattle on Feed data, September through December, U.S. feedlots with 1,000+ head capacity, placed 8.44 million head of cattle on feed, about 186,750 head more than the same four month period a year prior (Figure 1). Over that same time period, 1,000+ head capacity Iowa feedlots placed 56,000 head more than the previous year and less than 1,000 head capacity Iowa feedlots placed 99,000 head more. Ample corn supply, relatively favorable feed prices, and cyclically larger feeder cattle numbers likely contributed to higher placements.

Figure 1. Monthly U.S. Feedlot Placements, 1,000+ Head Capacity Feedlots



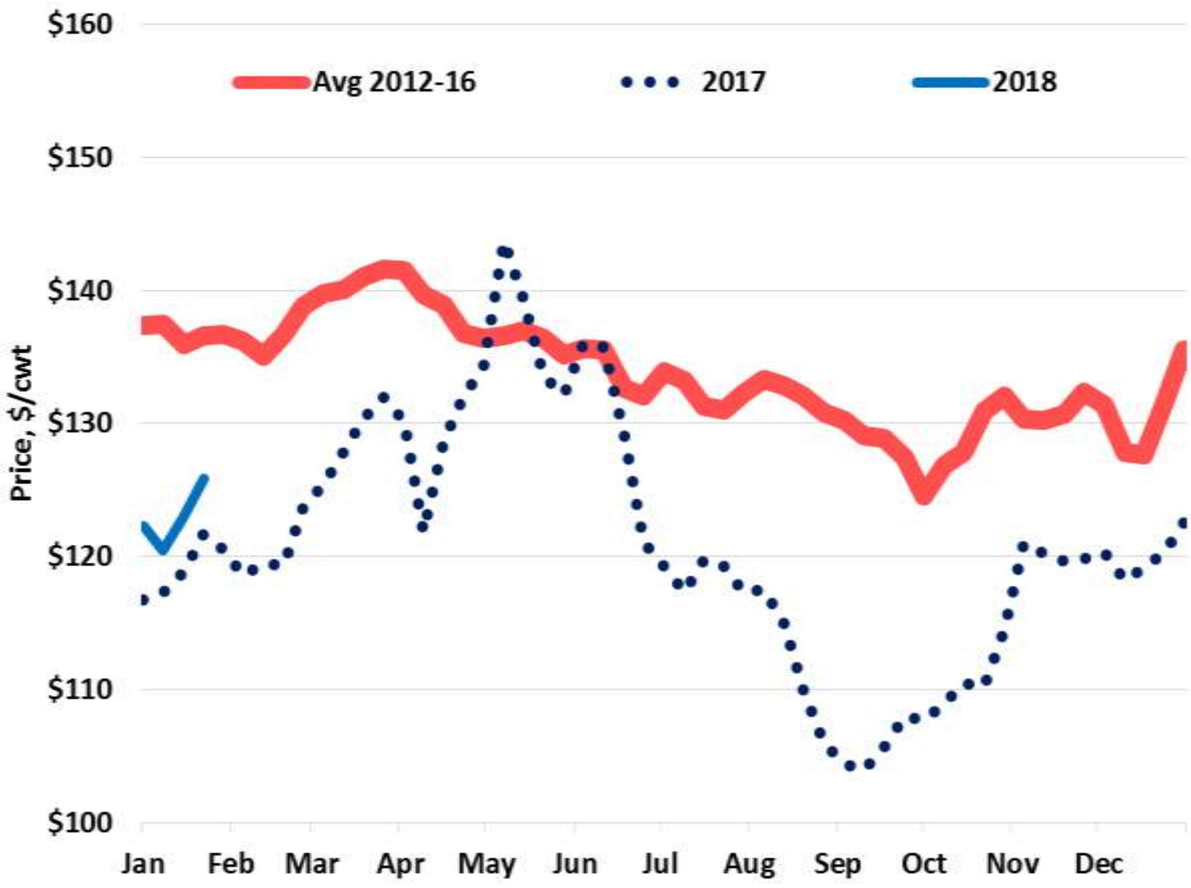
Source: USDA-NASS. Livestock Marketing Information Center.

While the strength in feeder prices cannot be fully explained or justified, at least relative to live cattle futures, it does not necessarily mean it will not continue. There is a strong positive basis between Iowa auction feeder cattle prices and feeder cattle futures prices. Over the last two months, basis for 700-899 pound steers has averaged $7/cwt. This is $2/cwt higher than last year. A tighter than expected supply of traditional yearling steers and solid demand for feeders that will likely finish before the ever so elusive June live cattle futures have contributed to the strength.

Basis has been running about $9/cwt higher than a year ago for feeder cattle weighing less than 700 pounds. Over the last eight weeks basis for 500-599 pound steers averaged $32/cwt, compared to $22/cwt last year. For 600-699 pound steers basis has averaged $20/cwt compared to $12/cwt one year ago. Basis for lightweight feeders is determined, in part, by feedlot cost of gain. With a relatively low and stable cost of gain, basis for calves is strong and will likely remain so for some time to come.

The wide basis continues to point to a discrepancy between what futures traders believe cattle prices are going to do and what cattle feeders think prices will do in the coming months. Cattle prices spiked in March, May, and June last year as retailers promoted beef very aggressively (Figure 2).

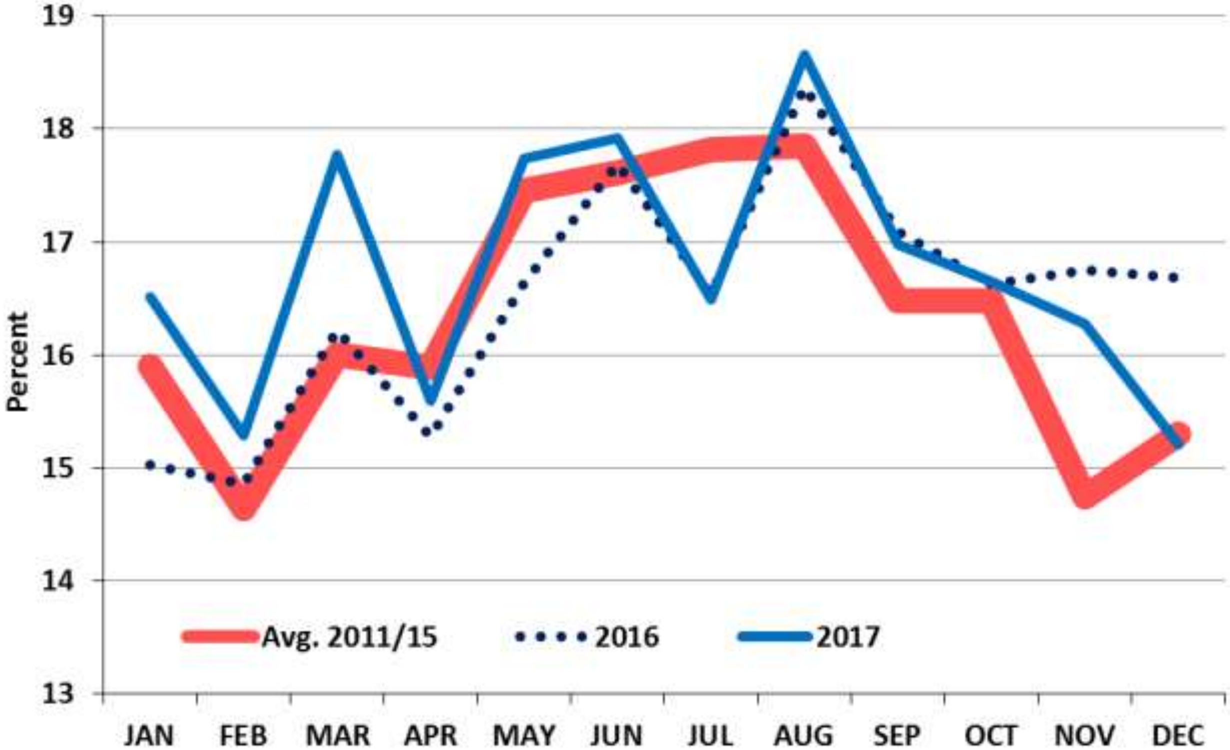
Figure 2. Weekly Slaughter Steer Prices, Iowa/Minnesota Weighted Average of All Grades



Data Source: USDA-AMS.

The fed cattle market was strongly supported by timely marketing of cattle too (Figure 3). From the start of 2017 to their peak the April and June 2017 live cattle futures contracts each gained roughly $25/cwt. Basis also strengthen which was good for hedgers and those holding a cash market position alike.

Figure 3. Monthly U.S. Fed Cattle Marketings as Percent of Cattle on Feed, 1,000+ Head Capacity



Feedlots

Source: USDA-NASS. Livestock Marketing Information Center.

Feedlot closeout values reached some of the highest levels in the last 15 years. March through June 2017 yearling to finish returns were estimated at an average of $344 per head on a cash market basis, i.e., assuming no hedging or forward pricing. These values were much higher than were suggested by futures market forecasts months earlier. Could be feedlots expect something to adjust to bring husky closeouts again this year. Such expectations could be encouraging them to bet on the come on feeder cattle prices now.

Market needs strong beef demand

Demand remains very critical for the beef and cattle market in 2018. Recent aggressive placements of cattle on feed should provide enough beef to support upcoming retail promotions with no issues. In general, increasing supplies result in lower prices. But how much lower, if at all, is key. If beef demand continues strong, retail price pressure may be rather modest with less negative impact on wholesale beef and cattle markets. A large enough increase in demand could offset greater supplies and maintain or increase prices. A strong export market will be necessary to support prices.

Feedlots need to remain current in their marketings. Will aggressively marketing cattle ensure that feedlot margins turn black? The answer is that it is not guaranteed to fix margins but it seems increasingly clear that failing to do it will ensure that margins remain red for the remainder of the year.

Live cattle futures for 2018 contracts have rallied roughly $5/cwt since mid-January. What no one knows is exactly how much more the market may rally. It is easy to conservatively state prices will trade at, or below, current levels. But as last year demonstrated, more upside can exist than generally expected (Figure 4). Prepare now to seize windows of opportunity that may open up in the days, weeks, and months ahead.

As cattle make their way through the system the next couple of months, packers will need to stay covered to support their forward sales. If cattle are green enough, indicative of a current market, cattle feeders at times could hold considerable leverage. Thus, there could be some price support moving into the spring and summer months. Being in position could result in positive returns.

Figure 4. Daily CME Live Cattle Futures, 2017 & 2018 Contracts

Source: CME Group.

Lee Schulz

Replay That Outlook One More Time

The crop markets have been amazingly consistent over the past few years. In preparation for this month's Iowa Farm Outlook, I reviewed my column from last February. The storylines are close to identical. So please bear with me as I revamp that column for this year. Over the past four years, the crop markets have faced the same situations over and over again. Many of the issues surrounding the crop markets in 2014-17 remain. Large crop supplies have been produced globally. Crop demands have reached record levels, but crop stocks continue to build. And prices have, for the most part, held below production costs. Projections for the upcoming crop year show that there are plenty of acres available for corn and soybean production this year as other crops cannot seem to compete. Combined, this would give us plenty of reasons to feel 2018 could be just as challenging.

Export demand for meat has accelerated over the past year. Global protein demand is driving livestock herd expansion, both here in the U.S. and around the world. That protein push is raising livestock demand (for the meat) and crop demand (feed for the livestock to create the meat). And the strength of the protein demand should bode well for crop exports in the future as the global livestock industry grows. USDA's current projections for 2018 indicate the export expansion should continue through the year (barring shifts in trade policy) for meat, but crop exports will be mixed. U.S. corn is not only competing against corn from other regions of the world, but also other feed grains which are also in plentiful supply. U.S. soybean exports are projected to rebound with the 2018 crop.

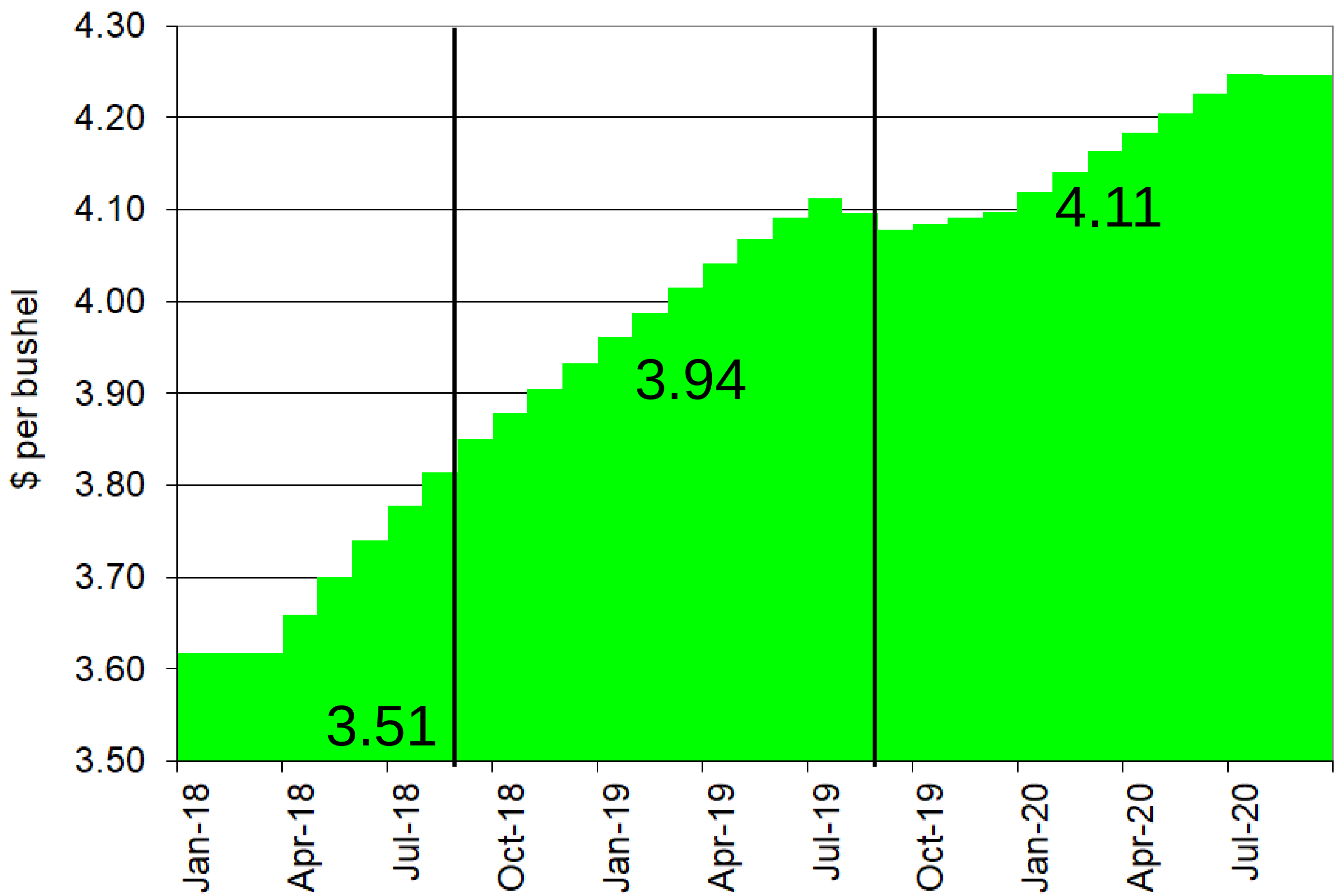
Corn demand remains very consistent. Livestock feed demand slowly worked higher. Meanwhile, ethanol has held at record levels. Thus, export demand is the weak link for the market right now. For feed demand, the trend is for continued growth. All sectors of the livestock industry remain in expansion mode. With meat exports expanding for poultry, pork, and beef, the U.S. meat production is set to grow by roughly four percent in 2017.

Ethanol production remains on a record pace. Throughout 2017, weekly corn usage for ethanol production exceeded 100 million bushels a vast majority of the year. While there are significant questions about the future of the Renewable Fuels Standard under the Trump administration, the key for the ethanol industry will remain with its ability to compete in the fuel market. Ethanol prices continue to be competitive with gasoline, especially now with oil prices back on the rise. Ethanol exports have strengthened as well over the past two years.

The soybean use picture is much like corn's. The growth in domestic crush demand is linked to the growing livestock industry. The feeding of additional cattle, hogs, chickens, and turkeys means more need for soybean meal. Soybean exports had hit record levels for the last few years, and while the current pace for exports is somewhat lower this year, 2018 looks to be a return to that record-setting pace.

No other crops (wheat, cotton, rice, sorghum, etc.) are really challenging corn or soybeans for acreage. Winter wheat plantings declined again this fall, opening up even more land for corn and soybeans. With the lack of alternatives, many producers will stick the crops they've recently grown (and grown well). The strong corn and soybean crops of 2017 will likely be followed by substantial acreage planted to both crops this year. In fact, the markets are expected a record amount of area to be devoted to soybeans, with estimates hovering well above 90 million acres. While corn may lose some acres, the crop will still be planted on roughly 90 million acres. So another round of great crops could be on the way.

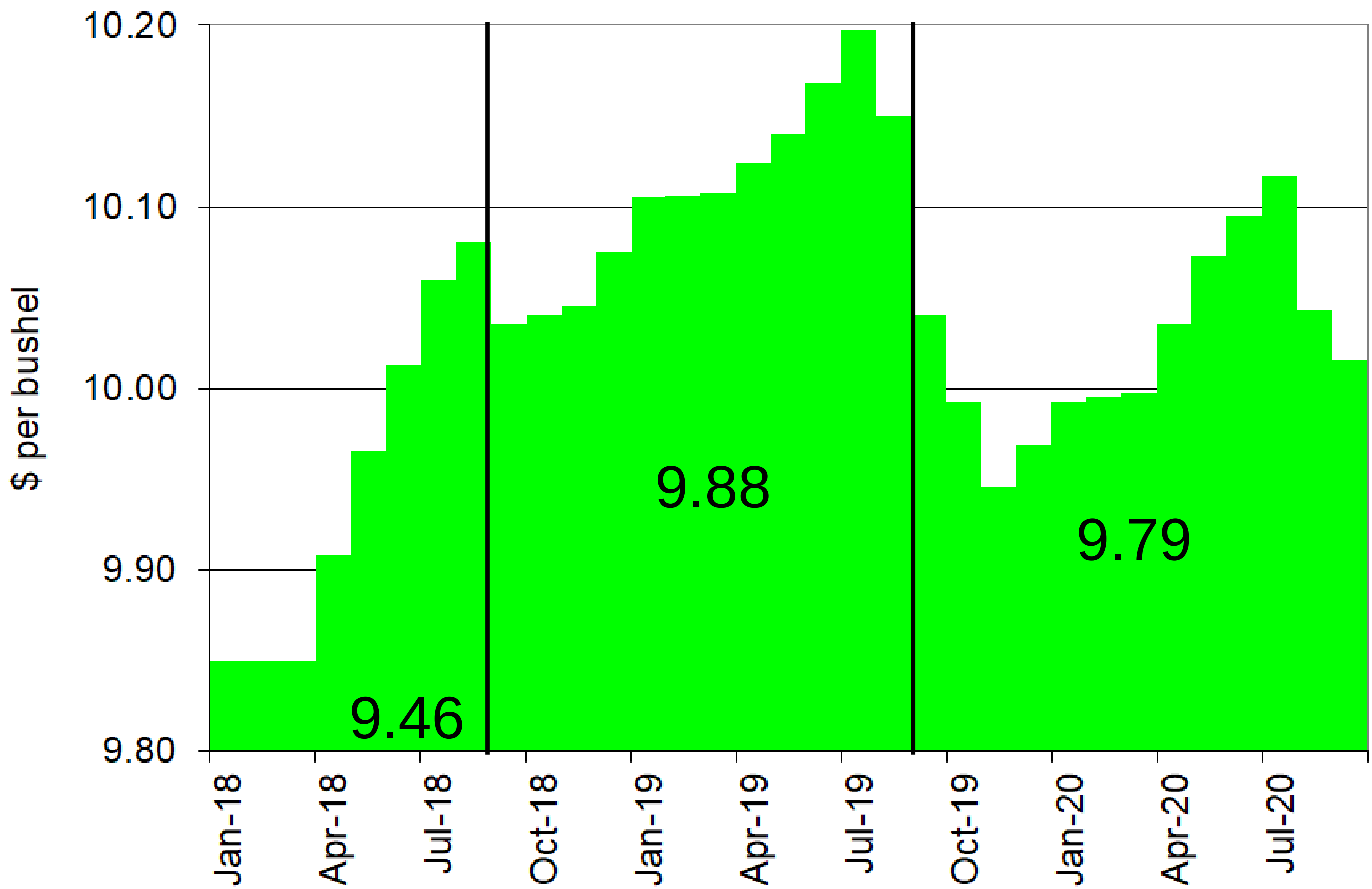
Figure 1. Corn Futures and Projected Cash Prices.



Looking at projected crop prices in Iowa for the 2017, 2018, and 2019 crops, the profit outlook is looking better than in previous years. In the graph above, current futures prices are shown with the green bars. The large black numbers are projected national season-average cash prices based on those futures. Production costs have diminished enough that some profit opportunities exist. Futures prices for corn are showing price improvement as we move through the next couple of years. Based on those futures prices, average cash prices in Iowa are projected to be in the $3.90 per bushel range for the 2018 corn crop. Looking further out in the future, average cash corn prices for the 2018 crop are projected in the $4 per bushel range. However, I must point out two caveats. One, the projected cash prices are based on average basis patterns, but basis levels will likely remain wider than usual. So I would suggest taking 20-25 cents off of these projections. Two, if you look back at last year's column, you will see that this graph basically is a replay. The market was providing the same outlook last year. But even with those caveats, the profit situation looks a bit better. With 2018 production costs in the $3.60 per bushel range, average cash prices at $3.70 and above would be profitable and a nice change of pace from the past few years.

The general story for soybeans is similar. ISU estimated production costs have fallen below $9.50 per bushel. Meanwhile, current futures suggest a 2018 average soybean prices near $10. However, the market seems to be preparing for a couple of years of global soybean production expansion, as prices for 2019/20 are lining up to be slightly lower.

Figure 2. Soybean Prices.



As was true last year (and every year), the key to knowing when you have a good price in front of you is knowing your production costs. It's hard to figure a profit if you don't know your costs. And there are some profitable prices on the board in Chicago and at the elevators today. We will still need to control costs and conserve working capital, but 2018 is offering some earlier opportunities to lock in positive cash flow. In 2015, 2016, and 2017, the markets ran higher in the late spring time based on strong demand and the possibility of slowing production, providing some good marketing windows. That window has opened again.

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