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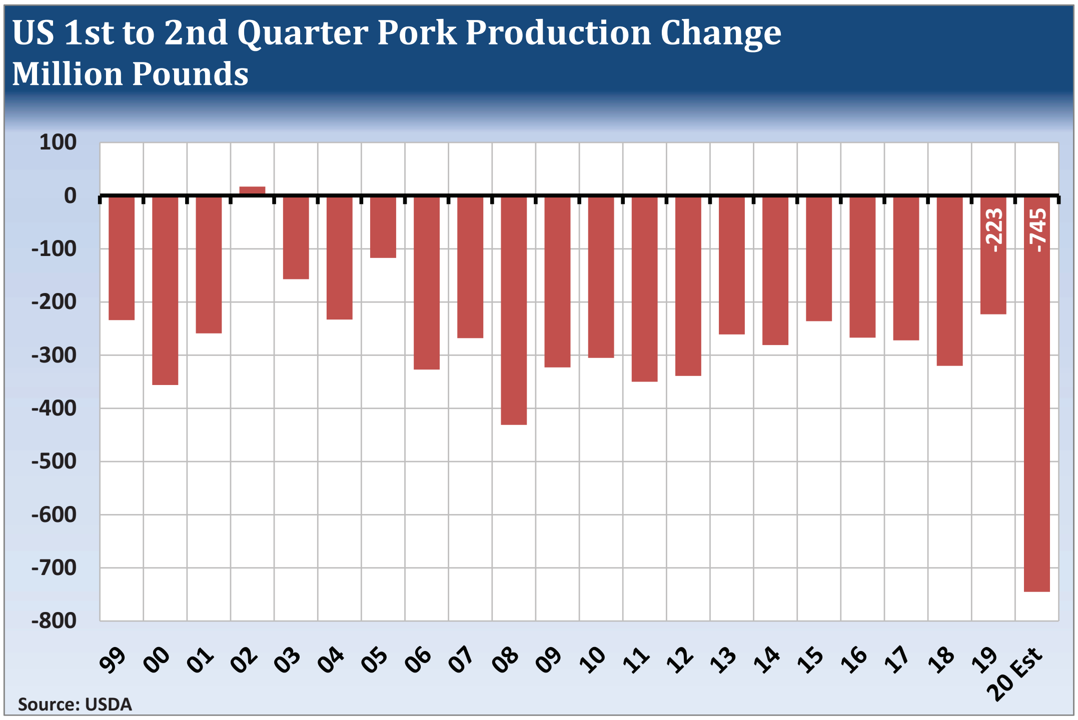
Lean Hogs: Looking Beyond COVID-19



The livestock markets seem to be pricing in a continuation of the very bearish short-term situation that has evolved at the nation's slaughterhouses. Hog and cattle slaughter rates have been sharply reduced over the past several weeks, especially this past week, as more and more processing plants have been closed due to a high infection rates among workers. As the smoke clears and virus issues at slaughter houses start to come under control, lean hogs should find support.

Of course, it is still possible that the infection rates will get worse and more and more plants have to close. Still, the number of new cases is declining in many states as "hotspots" are dealt with. Furthermore, the surge in pork prices should help incentivize slaughterhouses to resolve the situation quickly.

The pork industry could be in a very difficult situation for the next several weeks until the processing situation begins to improve. Pork values might continue to surge higher, but with the spread of virus at key slaughterhouses forcing local communities to step in and close plants, hog prices could continue to come under pressure. With 25% or so of capacity already idled, hogs could back up in the country very quickly. This could drive cash hog prices sharply lower.

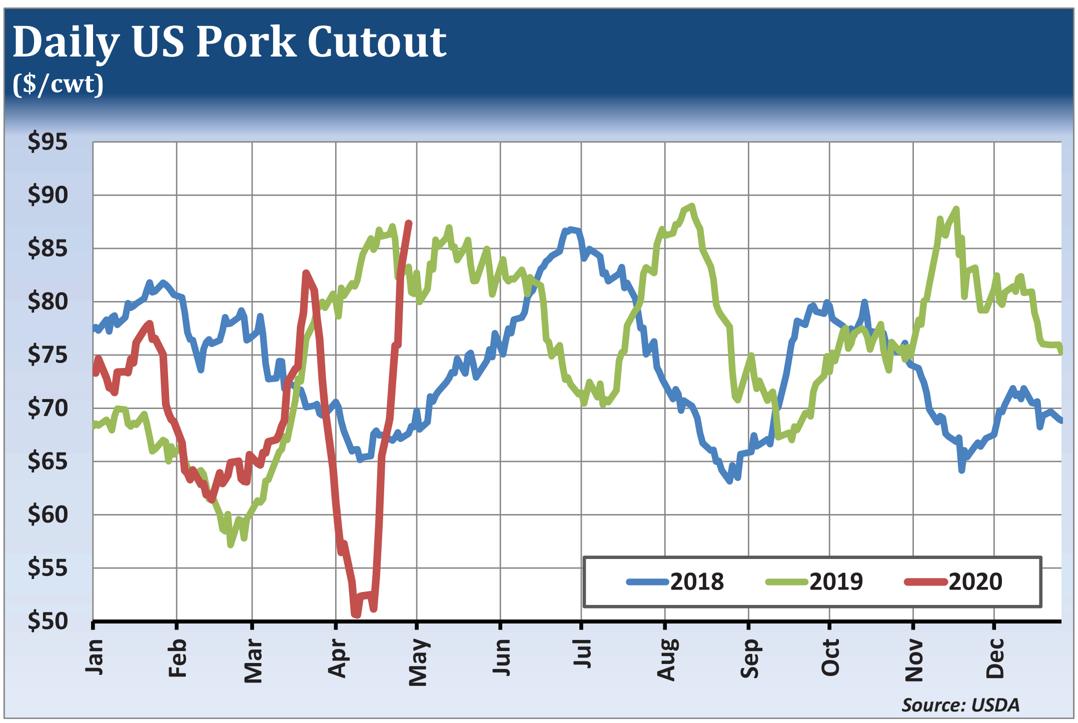
Tyson Foods has suspended operations at one of their key slaughter plants in Waterloo, Iowa. The plant can process 19,500 hogs per day or nearly 4% of the US pork processing capacity. More than

180 infections have been linked to the plant and the company indicated mass testing of its 2,800 workers would begin later this week.

This news is bearish, but traders sense that with the surge higher in pork product prices, the situation could be resolved fairly quickly, as processors will have the incentive to get back to normal as quickly as possible. As of Tuesday the USDA estimated hog slaughter had reached 568,000 head for the week, down from 719,000 a week prior and 939,000 a year ago. The total estimated slaughter last week was down 352,000 head from a year ago. Actual slaughter for the week ending April 11 was down 406,000 from its peak on March 21.

The USDA pork cutout reached $87.35 on April 28, the highest the cutout had been since November 18. The recent rally has been unprecedented; the cutout has gained $36.19 in nine sessions. Packer margins are deep in the black, which should help them quickly resolve some of the slaughter issues.

The shutdowns are seeing heavy coverage in the media, and the government is getting involved to try to help boost slaughter in the interest of keeping the food supply chain in place. President Trump has announced he will sign an executive order

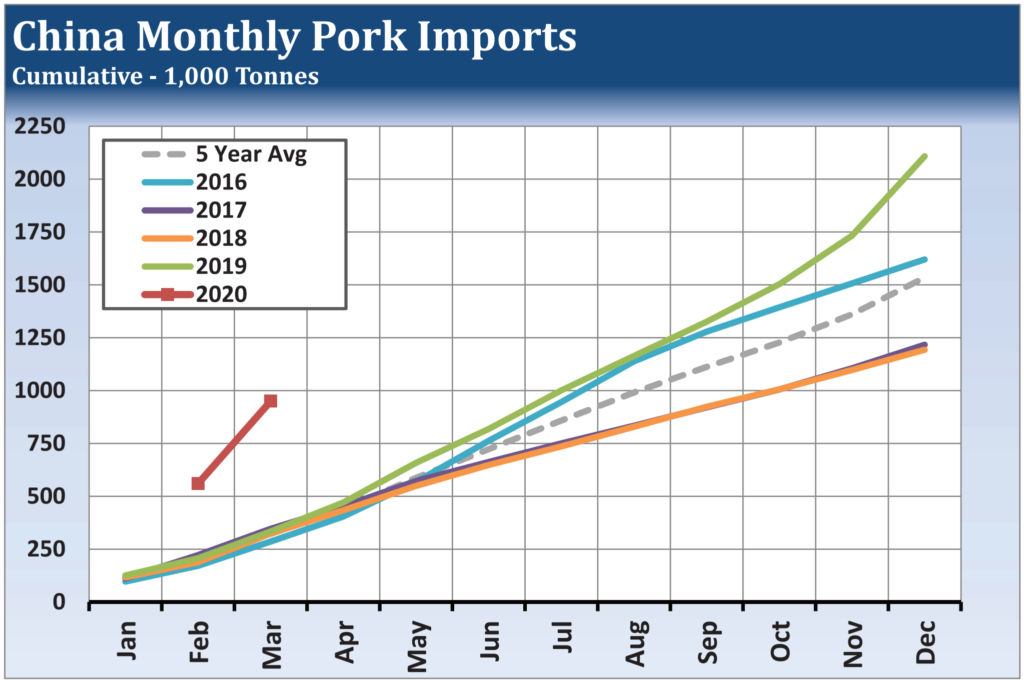


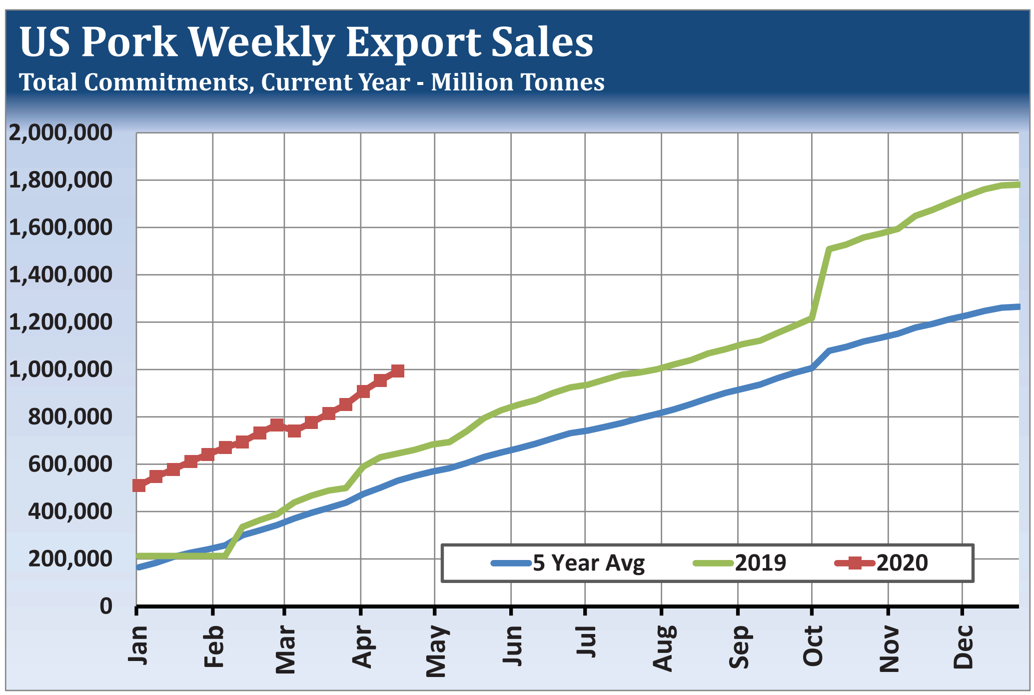
under the Defense Production Act compelling meat plants to stay open amid the pandemic.

China imported 390,000 tonnes of pork in March, up 45% from the same period last year. Their cumulative imports for the first quarter have reached 950,000 tonnes, versus a total of 2.11 million for all of 2019 and 1.19 million for 2018. They are on pace to import 3.8 million tonnes total this year. With the current price structure, China is likely to remain an active buyer of US pork. Such purchases would also help them with their 2020 Phase 1 commitments to buy US agricultural products.

Cumulative US pork export sales as of April 16 reached 993,800 tonnes, up from 645,282 a year ago and a 5-year average of 530,519. China has made the largest commitments at 389,163 tonnes, followed by Mexico at 228,496 and Japan at 117,361.

Strong demand from China, a seasonal decline in slaughter numbers into May and the potential reopening of restaurants in some areas are factors that could help hogs rally into the May-June timeframe.





Trading Ideas

Look for good support for July Hogs at the 58.22 to 54.70. Consider buying the market in the support zone looking for a spring uptrend, with 66.02 as resistance and 71.27 as the initial upside target.

Option traders can look to buy a July Lean Hog 60.00 call, sell a July Lean Hog 72.00 call, and sell a July Hog 48.00 put for a net premium paid of +115 points. Use an objective of +975 points on the combination, and risk a total of 180 points from entry.

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