

MONTHLY MARKET PROFILE: AUGUST, 2009
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July's market was neither systematic nor necessarily orderly with lots of tug and pull week-by-week. But don't get too caught up in the weekly distractions, what really matters is the larger assessment. The month opened with a surprising move to the upside with cattle feeders earning \$82-3. And the second week chopped along with slightly softer sales to finish mostly \$82. Things became interesting, though, in the middle of the month: feedyards managed to squeeze the packer and drive the market to \$84; that came without any discernible spot-market impetus as cutout values were steady. Fortunes reversed the very next week; wholesale values moved higher (up to \$142-3) and processors strangled any further gains in live prices. The month closed on a sour note; live sales were mostly \$1 off the previous week to end up back where we started (\$82-3) despite cutout values remaining in the \$140+ range. Needless to say, packer margins were very favorable as July ended and provided impetus for the largest throughput in the past five weeks.

The wholesale market's prosperity during the past several weeks is an important story. The upside represents a contra-seasonal move (though not nearly as large as last year's stimulus-driven surge). Perhaps more importantly, the market has seemingly established support at \$135 for the Choice cutout. Simultaneously, though, cutout values continue to find resistance in the \$140-145 range. Range-bound wholesale values will ultimately hamper upside potential for live prices; the market needs to break out to higher levels to facilitate any major moves in the fed market. So despite lots of continued enthusiasm about a supply-driven market, in the end what really matters is economics; consumers have to come back to beef to really drive the fed market to new levels. This is especially important to monitor given that 2nd-quarter GDP results indicate that consumer spending declined 1.2% between April and June (following a .6% increase in the 1st-quarter); unemployment worries, consumer confidence and higher savings rates will potentially cap spending in the months to come.

Now let's shift gears and look more broadly at what's occurring within the beef business. During the past year (actually, make that several years) I've provided extensive coverage about the state of flux within the industry and what it means going forward from a business perspective. Along that theme, USDA's cattle inventory and cattle-on-feed reports converged with several key indicators about what's really going on out there and provide insight into the collective decision-making within the industry. None of this is really news but important to review.

First, July represents the 15th consecutive month in which USDA's cattle-on-feed inventory has culminated in declining numbers versus the previous year. July's inventory was 7% below the 5-year average and represents the smallest feedyard population since August, 2003. Even more important, though, are indicators that the slowdown may actually be hastening. Reluctance to place purchase cattle for feeding ventures has been especially pronounced during the past several months. June placements were pegged at 1.391 million or 8% below last year's arrivals and 19% behind the 5-year average; May arrivals were 14% behind 2008's pace and a whopping 22% behind the 5-year average. The 2-month combined total of 3.029 million head represents the slowest arrival rate since June/July, 1996. None of this is a new trend – waning appetite for risk has forced placements to be in decline over the past several years (see graph below).

Second, USDA's cattle inventory report revealed continued decline in beef cow numbers – 450,000 fewer (1.4%) versus 2008. More importantly, 2009 extends a long-term streak: producers have maintained fewer beef cows in the July 1 inventory report twelve out of the past 14 years (the other two years in that mix represent a zero- and 50,000-cow increase in 2006 and 2005, respectively). All said, we've witnessed 3.9 million cows, or a little over 10% of the total population, disappear since the recent peak in 1995.

Lastly, July's cattle-on-feed report also included regular quarterly breakdown of the respective steer versus heifer population. What's important here is the fact that waning placements aren't the result of sudden spring intent to build the cowherd and intent to retain heifers. In fact, the proportion of heifers within the feedyard population is actually inching upwards and currently stands at 38%. That trend coincides with the cattle inventory report: heifers held as beef cow replacements declined to 4.5 million head – a year-over-year decline of 100,000 head (2.2%). July's Monthly Market Profile asked the question whether the industry is caught in an adverse-feedback cycle. At the very least, recent data indicate an industry which is in deep distress.

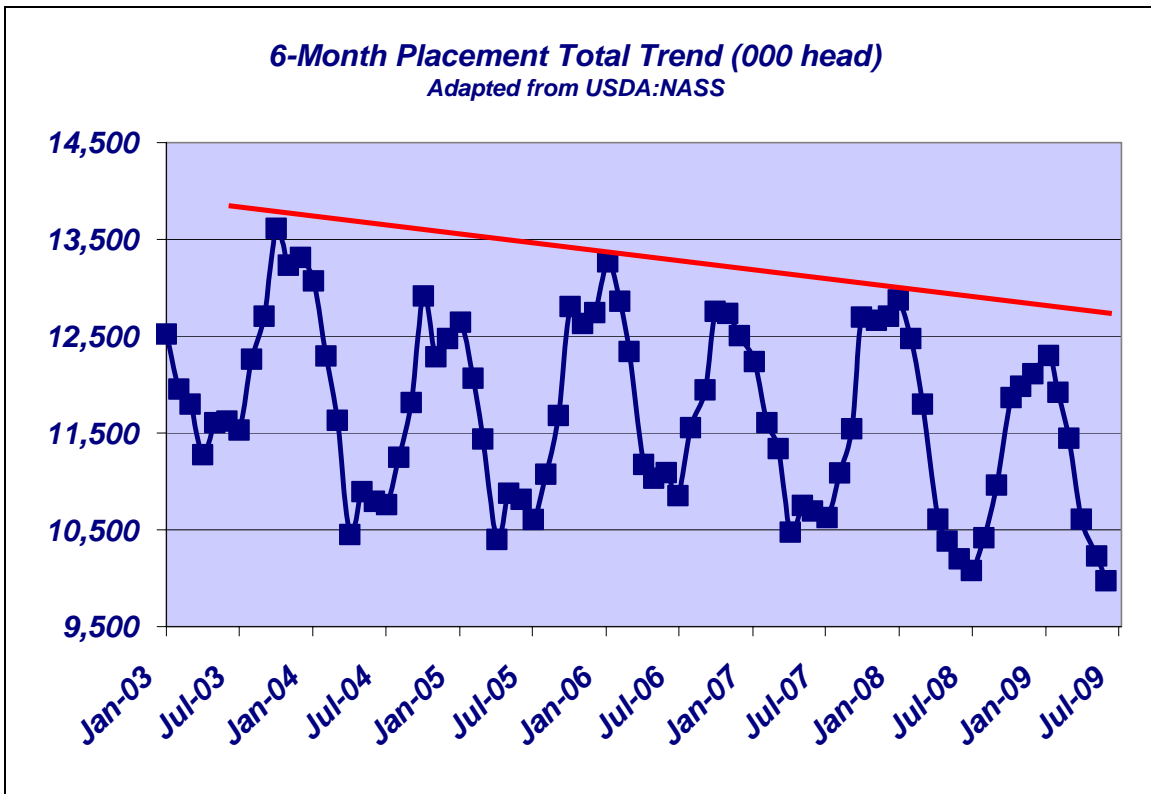
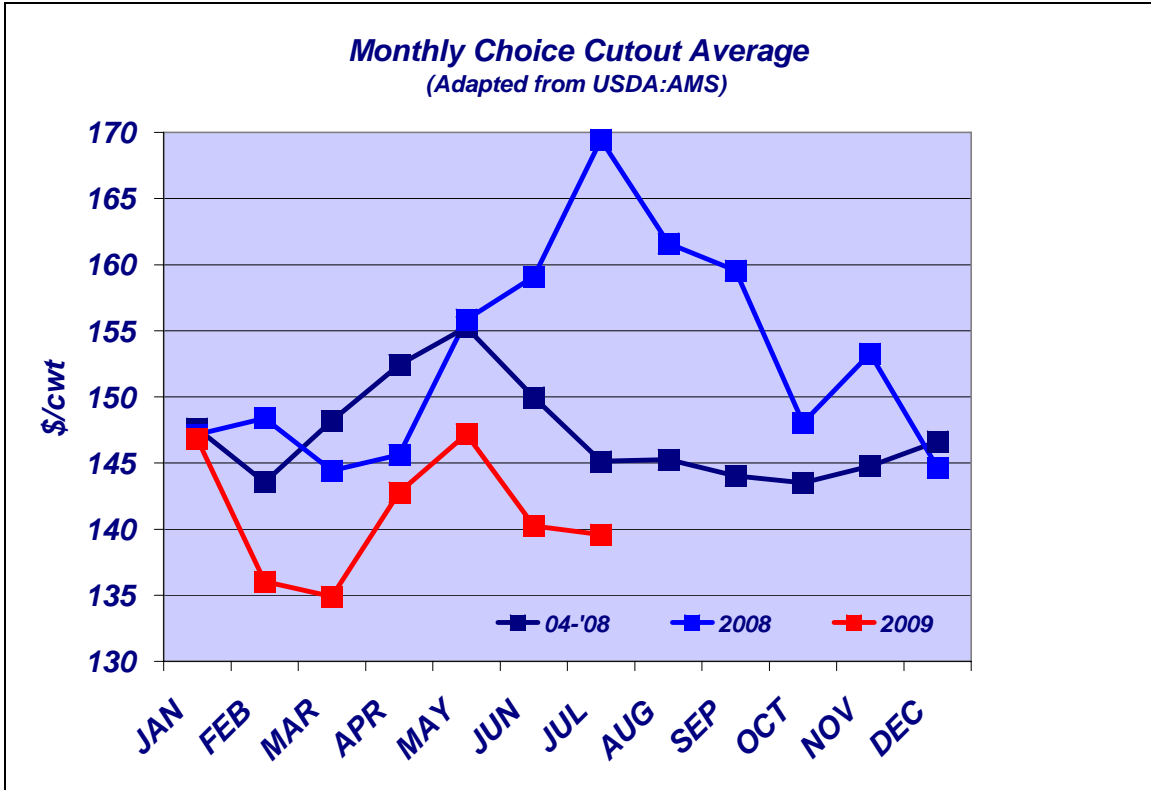
The question then becomes what to make of strategy going forward. There are two fronts to deal with. The first is consumer psychology and spending – an important component which ultimately dictates the amount of revenue flowing through the industry. Unfortunately, it appears over the short-term the consumer will remain under pressure to shore up his/her personal balance sheet until there's substantial job creation within the economy. Joshua Shapiro, Chief U.S. Economist, MFR Inc., recently explained why spending improved following the previous recession despite being coined as a “jobless recovery” (interview with Tom Keene, *Bloomberg on the Economy*, July 23): “The last time around, consumers outperformed the labor market because they were using their homes as ATMs and credit was freely available. That's not the case this time.” That issue mandates careful monitoring and speaks directly to the wholesale market discussion above.

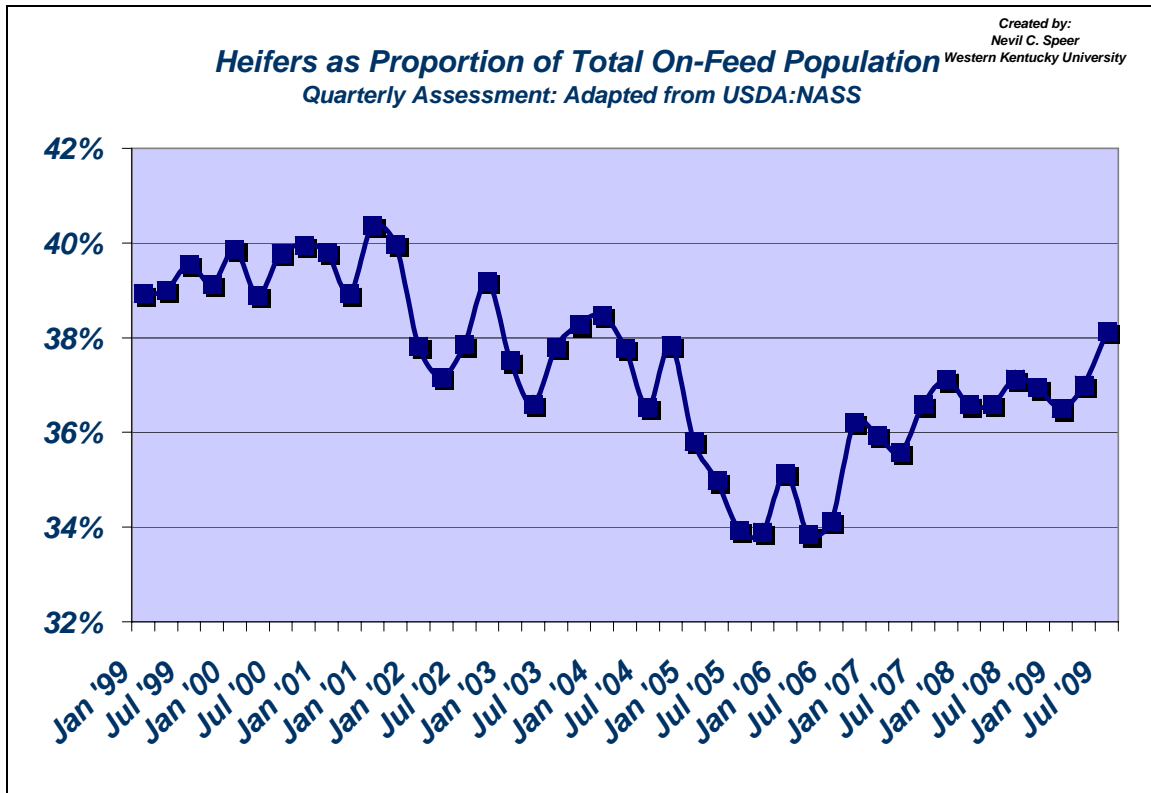
The second front comes in the form of overall business investment front and the overarching issue of excess capacity. Mr. Shapiro also made some important observations that have direct application to the beef sector. He was asked about clearing capacity and the economic history as it relates to this recession. Does it stem from consolidation?:

Yes, consolidation is the best way. And again, if you look at a lot of things the government has been doing, it's kind of anti-consolidation. A lot of it is propping up things that maybe shouldn't be propped up and we should at least allow the process to naturally take its course and reduce excess capacity that way. The more you do the “Japan sort-of thing” the longer your pain lasts.

Consolidation and government involvement – two imperative issues we constantly wrestle with in the beef complex.

What's really important here is to evaluate all of this within the current business and economic environment. To date, producer-level consolidation has largely occurred because of demographics and/or lifestyle choices at the cow-calf level and pursuit of economies of scale at the feedyard level. The next wave of, or impetus of ongoing, consolidation will likely prove to be different; it will be not be driven by either of those factors but rather be catalyzed by the financial industry. Access to capital (or lack thereof) – both on a personal or corporate level – will dictate the entities which can continue to pursue their respective business interests.





PRICE SUMMARY**WEEK ENDING:**

	31-Jul	24-Jul	17-Jul	10-Jul	3-Jul
Slaughter Steers (\$/cwt)	82.76	83.19	83.62	81.36	82.81
Choice Cutout (\$/cwt)	142.53	141.45	137.39	137.81	138.76
Select Cutout (\$/cwt)	136.79	135.20	131.22	132.44	132.79
Hide and Offal (\$/cwt)	8.23	7.57	7.17	7.10	7.20
USDA Slaughter Weights (lb)	1282	1279	1276	1272	1270
USDA Steer Carcass Weights (lb)	846	840	840	832	832
CME Feeder Cattle Index (\$/cwt)	102.13	102.55	101.29	100.93	98.87
Cow Cutout (\$/cwt)	109.93	110.70	112.35	112.68	112.02
Corn (basis Omaha: \$/BU)	3.20	2.95	3.02	3.04	3.20
Cattle Harvest (000 head)	639	615	627	628	628
Beef Production (million lb)	497.2	477.3	484.9	483.6	482.2