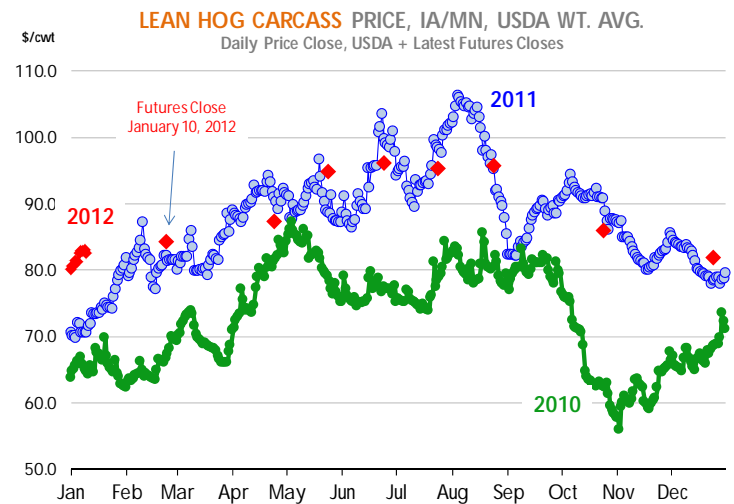
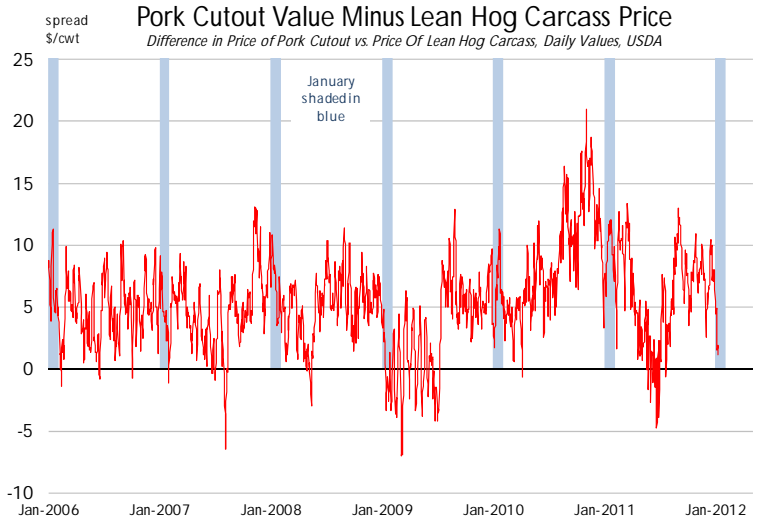


## Market Comments

Lean hog futures gained some ground on Tuesday and yet the market remains concerned about the ability of packers to push prices higher in the coming months. Somewhat worrying has been the sharp decline in the spread between the cutout and lean hogs. This implies worsening margins for pork packers and limited upside for the hog market in the short term. The attached chart shows the spread between the pork cutout and the lean hog carcass since 2006. We have highlighted the January months so that you can see how the current spread compares to previous years. On Tuesday, the pork cutout was valued at a \$1.15/cwt premium over the hog carcass. Looking back, the current situation appears most comparable to January 2009 when the spread between the cutout and carcass values actually dropped into negative territory and hovered around those levels for much of the first part of the year. In that year, both hogs and pork cutout were generally flat as poor demand hampered the normal seasonal upswing. We are not saying that this is a repeat of 2009, the economy and industry are in a very different place. But the spread bears watching and we need to see a more robust wholesale pork market to justify any meaningful appreciation in hog values from current levels.

At the moment futures are pricing hogs for 2012 at about the same level as in 2011 (see bottom chart), having taken almost a dime off the valuations made back in October when pork and hog prices were flying high. The April contract closed on Tuesday at \$87.35/cwt, about 38 points higher than the previous close but some \$8/cwt. or 8.3% lower than where the contract was trading back in October. The pullback has been driven in large part by lower hog and pork prices into the year-end as well as speculation that producers will respond to the improvement in their profit outlook by expanding production. Some market participants think that producers may be chomping at the bit to expand production after being at a standstill for a number of years. So far any growth in the industry has happened via improvements in productivity and operators have learned to become ever more efficient in the face of escalating feed and energy costs. Eventually, however, producers will start to grow the herd. This speculation runs counter to what the latest hogs and pigs report showed, with producers indicat-



ing in their surveys that they expect farrowings to be slightly lower in first part of 2012. Exports remain a wild card going into 2012. The free trade agreement with Korea and improving economic outlook for the global economy are positive for US pork exports. But the situation in Europe remains a key risk and fears of a hard landing in China persist.

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