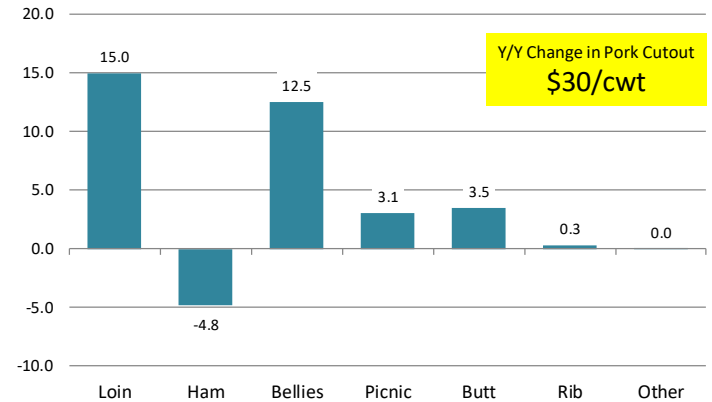


**Nearby lean hog futures have rallied around \$20/cwt in the last three weeks, which may appear baffling given all the talk of hogs backing up in farms and the inability of producers to get them processed in a timely fashion.** The gains would appear especially strange to those used to consulting such cash market benchmarks as the IA/MN lean hog carcass base price (LM-HG206) or the national hog carcass base price (LM\_HG203). Last night, for instance, the national base price was quoted in a range of \$35.96 - \$45.00, with a weighted average value of \$36.62. May lean hogs settled yesterday at \$68.80. We have gone over this before but it bears repeating - the lean hog futures contract settles to the CME Cash Hog Index. **And the cash hog index is based in part on hogs that are priced using the cutout not just the negotiated market.** So there are two inputs that affect the value of the CME index - the negotiated market (either directly negotiated hogs or formula hogs that use the negotiated market) and the wholesale pork market. **As the value of the pork cutout has skyrocketed recently, it has helped pull up the calculated value of the hog index.** Last night, USDA quoted the carcass value of negotiated hogs at \$36.43/cwt. When accounting for premiums/discounts, the net price was \$37.55. But only 3,571 hogs were priced directly this way. There were another 62,953 hogs that go into the other bucket used to calculate the index - these are called “producer sold (hogs) swine or pork market formula.” The carcass value of these hogs was \$68.03/cwt and when accounting for discounts/premiums it was \$68.98. **The spread between the net price of the formula priced hogs vs. the negotiated market was over \$31/cwt, as high as we can find in the records.** That spread has been widening since mid April for the simple fact that limited slaughter has caused pork wholesale prices (cutout) to move sharply higher. **Lack of slaughter capacity has removed any bargaining power from the producer and thus negotiated prices are stuck in neutral.** Last night, the value of the pork cutout was calculated at \$116.74/cwt, up \$65/cwt or 124% from April 15 and \$30/cwt or 35% higher than the same week a year ago. The top chart shows what’s driving the y/y gains in the value of the cutout. Loin prices have surged higher as tight supplies have resulted in more competition and higher prices from retailers. Belly prices are also very strong, possibly because processors are caught short at a time when foodservice operators are looking to refill the pipeline. Ham prices are softer, we think because lack of labor has limited the number of hams that can be boned. You could grind these hams if you could get that darn bone out, the value of 72CL trim is \$120/cwt but #23-37 hams last night were under \$47/cwt.

**The second chart to the right shows the shift that has happened in the relationship between the pork cutout and the CME cash hog index.** Normally the relationship between the cutout and the index is not perfect because of that other component that drives the index - negotiated hogs. While pork prices and negotiated hog prices normally has some relationship, in any given day there is some divergence between the two. Since the middle of April, however, the negotiated hog market has had little impact on the index. The moves in the index have been almost entirely driven by the

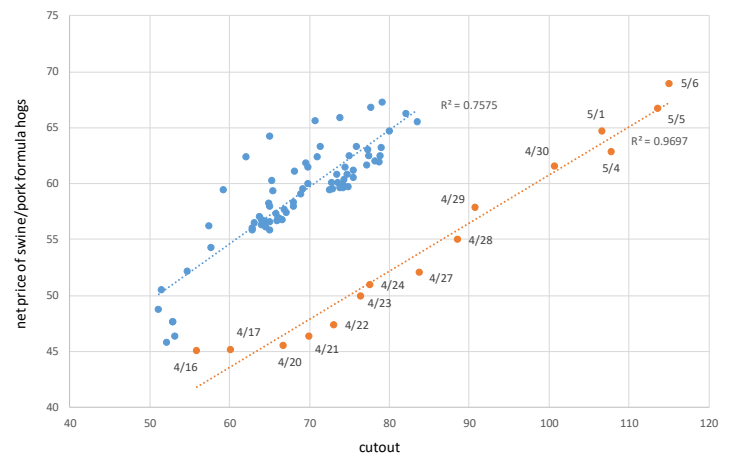
## Contribution to the Y/Y Change in the Value of the Pork Cutout

Based on USDA-MPR data for May 7, 2020 vs. yr ago. Analysis by Steiner Consulting

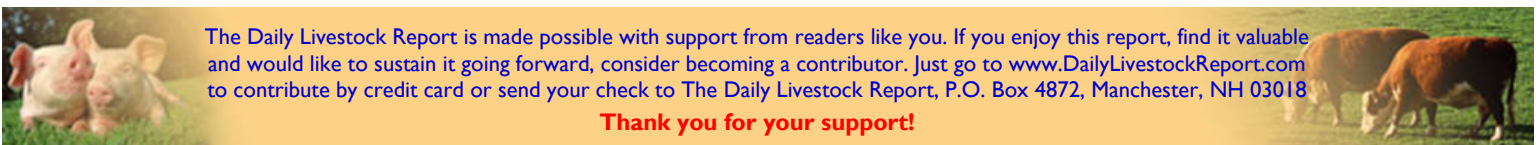


## Relationship of the Pork Cutout vs. Net Price of Swine/Pork Formula Hogs

Price Information: USDA-AMS. Analysis by Steiner Consulting



changes in the value of the cutout ( $R^2 = 0.97$ ). In the near term, market participants will likely pay close attention to shifts in the cutout in order to assess the price potential for CME hogs, at least in the near term. The formula in the chart above would imply that for a \$5 change in the value of the cutout one should expect a \$2.15 change in the value of the index. Hog plants are slowly opening up and we think by next week they will all be operational. However, capacity and especially labor for fabrication will be tight. Slaughter capacity may be challenged in the near term but it is anyone’s guess how big that shortfall will be. Daily slaughter and the resulting impact on cutout will be a critical factor to watch in order to assess the price potential for summer hogs.



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