

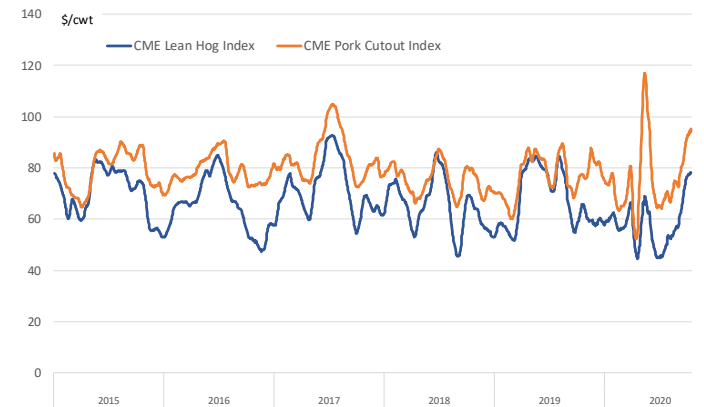
On September 29 CME Group announced that it would launch pork cutout futures and options. Quoting directly from the CME news release, the Exchange believes that “The Pork Cutout futures and options are complementary to our Lean Hog contracts and will provide clients with the ability to manage risk and discover price from the hog all the way to the meat case.” The news release issued at the time noted that new product would launch on November 9 and we have not seen anything different so far. The new contract is cash settled based on the CME Pork Cutout Index “for the five-day period ending the day on which trading terminates.” The contract will settle on the 10th business day of a contract month and the listing cycle follows that of the Lean Hog contract. [For those that have not seen the details or have general questions, you can see all that from a special FAQ page that CME has set up.](#)

Our purpose today is to look at how the Pork Cutout Index compares to the current Lean Hog Index. In broad terms the two contracts represent prices paid for hogs and prices paid for pork at wholesale. The CME Lean Hog Index is calculated by using a two day average of hog prices as quoted by USDA in their report “National Daily Direct Hog Prior Day Report-Slaughtered Swine.” That report outlines the price of slaughter hogs paid in the previous day depending on the type of marketing arrangement but **only the price of hogs traded on a negotiated or swine/pork formula basis are used in the calculation.** Some of the hogs in the second bucket, which is by far the largest, are priced using the cutout so the wholesale pork price already influences the CME Lean Hog Index. However, at any given point we do not know how many hogs were priced using the cutout. So while the inclusion of cutout priced hogs in the Lean Hog Index has helped tighten the livestock-meat spread, that spread still tends to move around quite a bit. It should also be pointed out that while the CME Lean Hog index uses a two day average of the relevant hog prices, the CME Pork Cutout index uses a five day weighted average of the USDA cutout. This is understandable since wholesale prices in any given day can move around quite a bit and the five day average should help eliminate some of the noise. Since 2015, the average spread of the CME Pork Cutout Index and CME Lean Hog Index has been \$11.9/cwt. But there is some seasonality in the spread, as shown in the last chart to the right. But even in the last three years the numbers have been all over the place. Q1 spread for the last three years averaged \$10/cwt with limited variance. The spread in Q2 averaged \$6.9/cwt but it ranged from \$11.4 in 2017 to \$2.6 in 2019. Then came COVID and the average spread in Q2 of this year was \$24.4 with a high of \$51 on May 11. The average spread in Q3 for the past three years has been \$11.1 and Q4 has averaged \$15.4.

One final note regarding the wholesale prices quoted daily by USDA. USDA releases both a morning report and afternoon report on the cutout, with the morning report coming out during trading hours. While hog traders likely did look at the morning cutout report as an indication, the may become even more pertinent now that there is a contract tied directly to the cutout. The issue is that the morning report tends to vary greatly from the afternoon report since it only captures whatever trades are done as of 9.30 AM. We were not able to get a full data set of prices from the morning report in time to analyze here but quickly pulled the price information for the past two weeks. **Since October 1, the average pork cutout reported in the AM sheet varied 3.4% from that reported in the afternoon and prices were higher in the AM sheet in 9 of the 10 days we reviewed.** Some items, such as hams, varied an average of 8.8% and sometimes were as much as 28% different from AM to PM. This should be an important consideration when looking at the AM report. It is important to look not just at the headline number but dig into the details and see if thin volume is skewing prices.

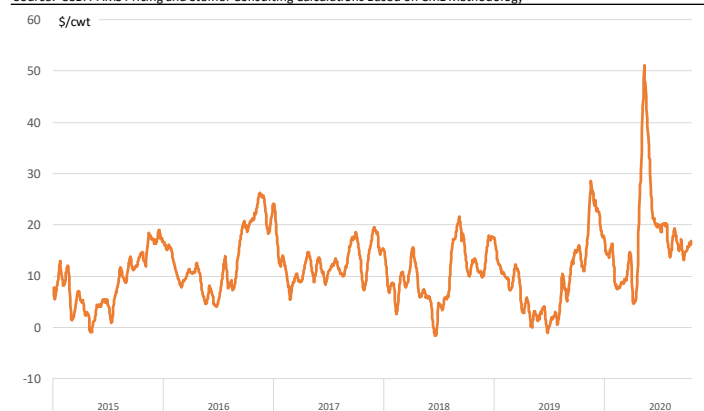
5-Year Daily History of CME Pork Cutout Index vs. CME Lean Hog Index

Source: USDA-AMS Pricing and Steiner Consulting Calculations Based on CME Methodology



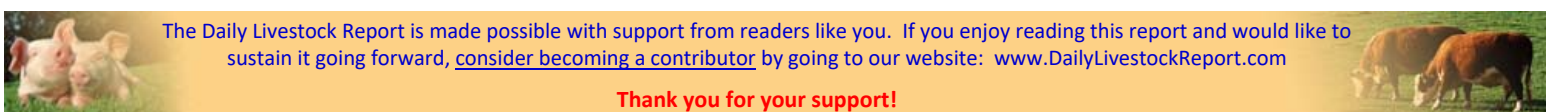
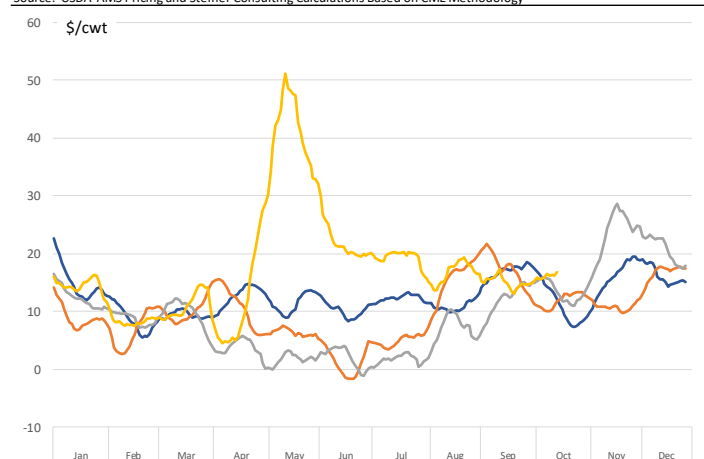
5-Year Daily Spread of CME Pork Cutout Index vs. CME Lean Hog Index

Source: USDA-AMS Pricing and Steiner Consulting Calculations Based on CME Methodology



Spread Seasonality in 2017 - 2019 and 2020 Performance YTD

Source: USDA-AMS Pricing and Steiner Consulting Calculations Based on CME Methodology



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