

MONTHLY MARKET PROFILE: JANUARY, 2010
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“We’re in a dark wood and the way is not straight.” That’s how my favorite presentation slide, at least during the past year, is entitled. It appropriately depicts broader economic uncertainty (a dark wood) as we progressed through 2009; a year best characterized by survival, navigating through a constant barrage of unknowns – the beach landing. This year is different: the unknowns are now largely known and the work ahead becomes more about grinding it out (but the way is not straight). The overarching theme in 2010 is resilience – we’re in the hedge rows fighting our way out to some open ground.

The new year (and decade) brings about a rash of assessments. Conventional wisdom for the beef complex is seemingly predicated on the following assumptions: 1) the worst of the economic downturn is behind us, and 2) beef supply will tighten even further from 2009 levels. Given the various indicators it’s difficult to argue with either of those suppositions. On both counts, those expectations are supportive for prices looking ahead – at least over the short-run. And making sense of the daily grind is important with respect to near-term marketing decisions.

However, emphasis within the Monthly Market Profile has always been geared more towards broader business implications: protecting capital at risk and investment decisions for the long-run. Given that, 2010 is very critical for the beef industry and finds itself at an inflection point. There remain lots of questions about potential drivers of change and factors which might jeopardize sustainable business operations in the year(s) to come. That’s best reflected by the overall trend in fed cattle prices (see first graph below). Will the market find renewed support to reverse direction or continue to lower levels? My objective is to provide some coverage of those key drivers in the pending months.

Topping the list is demand! Easily overlooked and often misunderstood, it’s useful to remind ourselves that aggregate demand is a function of five key factors: population, income, tastes/preferences, expectations, and the price of other goods. For example, simply increasing the average value (i.e. price) of a typical transaction does not equate to better demand; higher prices invoke concerns about quantity - raise a good’s price and people purchase less of it. Neither does doing more of something necessarily source from improved demand; put everything on sale – consumers will always purchase more product but it must be at a lower price.

The point is that increasing the number of customers, the average value of a typical transaction and increasing the frequency of beef purchases are NOT drivers of demand. Rather, they’re outcomes of improved demand. In other words, what needs to be done is to grow markets, influence consumer preferences, reinforce promotional efforts and ensure delivery of quality products. That’s not an easy task: altering consumer habits, especially those involving food purchases, is extremely difficult and takes immense effort.

Some historical perspective provides some broader context. The beef industry found itself presented with unforeseen challenges and required repositioning in the early 1980s. Beef’s market share was being challenged by mounting diet / health concerns and damaging misperceptions about the wellness attributes of beef products. Add insult to injury, NBQA 95 revealed new concerns. Beef’s primary market advantage, palatability, was slipping – especially troublesome given that it is the foremost motivator in consumer purchasing decision and allows beef to demand relatively higher prices in comparison to competing meat sources.

Therefore, the industry was challenged across numerous fronts over an extended period of time: unfavorable wellness / health perceptions of beef, product inconsistency, and a lack of preparation convenience; simultaneously, its costs were disproportionately rising compared to its competitors. Meanwhile, the pork and poultry industries were very aggressive in attacking both sides of the value equation; both industries improved their respective perceptions among consumers while also becoming increasingly efficient. Subsequently, the industry found itself

with weakening perceptions of its price/value relationship. The competition (pork and poultry) successfully exploited the weakness and captured an ever-increasing portion of market share.

Consumer spending is a more tangible depiction of the discussion above (for reference see the 2nd illustration below). Meat purchasing decisions, as with any product, are not made independently; they occur within a comparative framework versus competing products (pork and poultry). The graph below illustrates that the beef industry possessed a declining consumer base during the previous two decades. Between 1980 and 1998 the gap widened substantially: pork and poultry combined for over \$112 in spending growth, the beef industry only \$6.

Now consider 2003/4: unprecedented prosperity was enjoyed by the beef industry with profit opportunities being available for all segments. Good fortune stemmed from several key factors. Some attempt to leverage the Canadian import ban being the foremost reason. That perspective, though, fails to account for domestic consumer behavior. The real story was demand; it's the primary factor that boosted and sustained the surge – new product offerings, effective advertising, improvement in beef's dietary connotations and a surging consumer spending (which is now catching up to us). Further explanation is provided by inevitable consumer preference rotation resulting from chicken fatigue and rediscovery that beef tastes good.

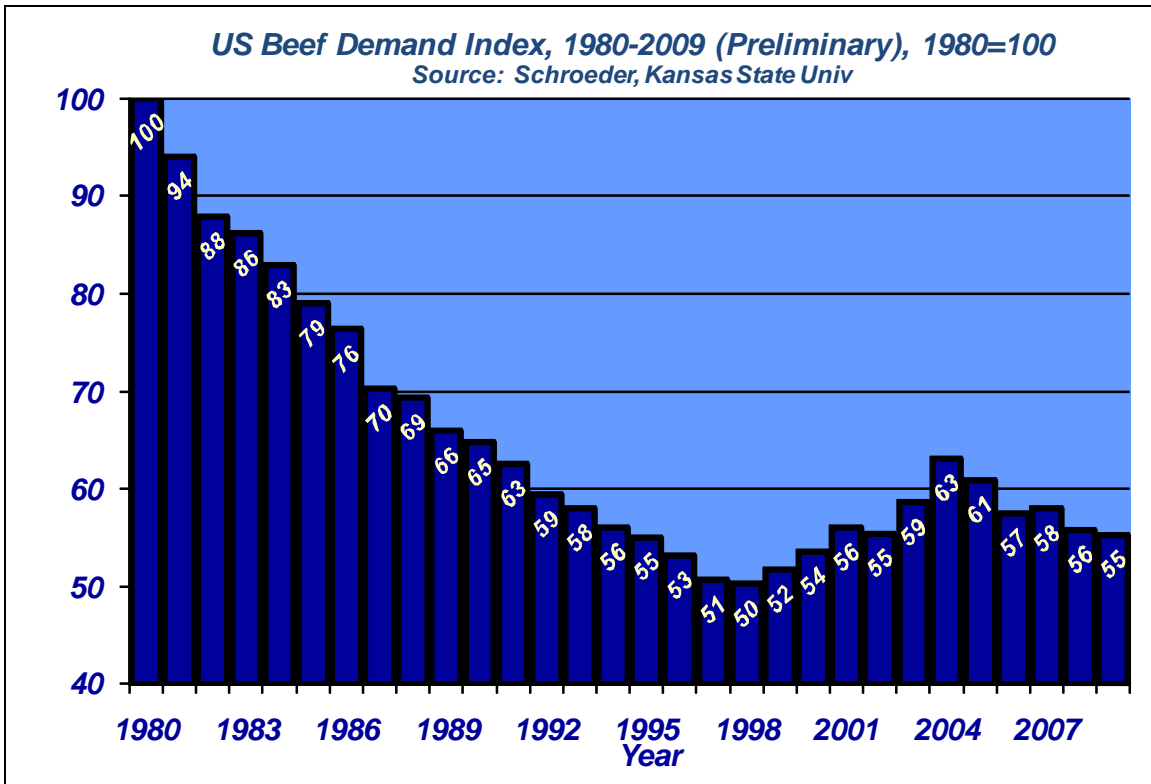
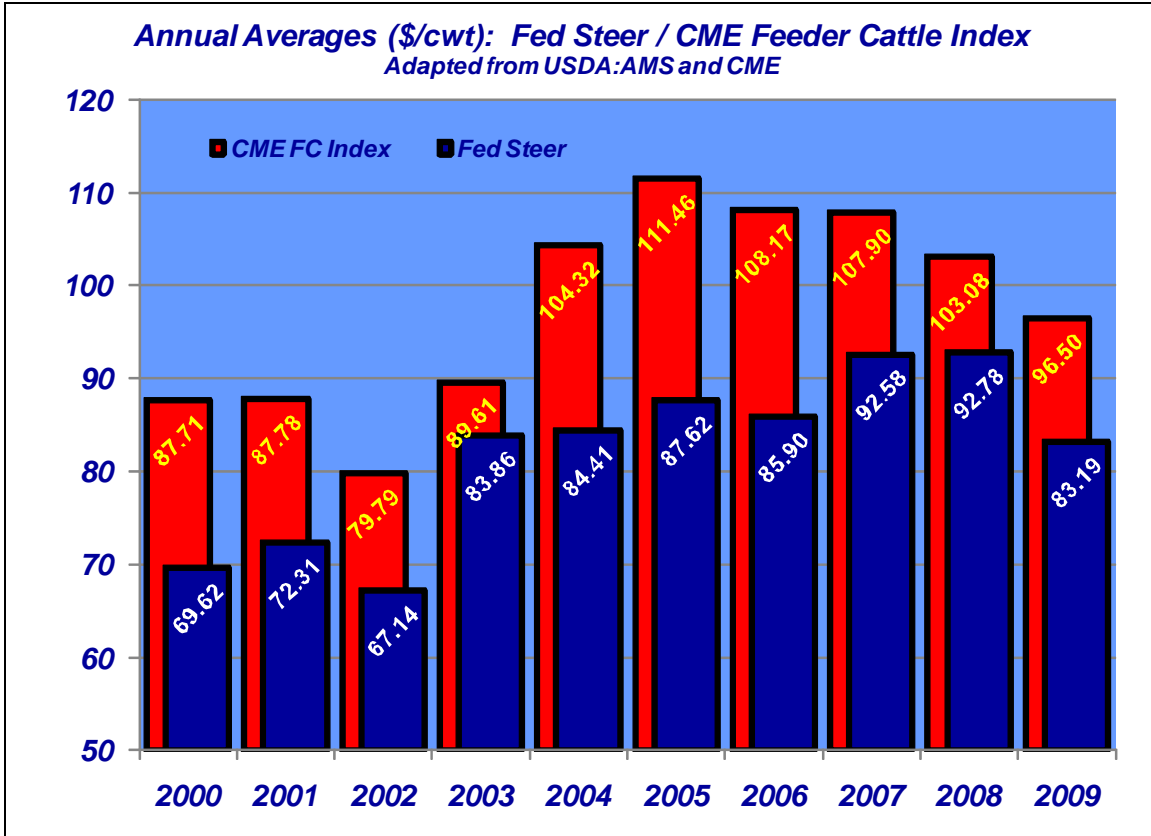
Unfortunately, we've since reversed direction. Per capita spending is forecast to decline in the coming years – those projections by USDA released a year ago and developed before full manifestation of the financial crisis (this year's numbers may look worse yet). Meanwhile, the entire meat industry seems to be under pressure from increasingly emboldened activists of all kinds - the "anything-about-meat-is-bad" mentality is increasingly pervasive. Where does that leave us? Namely, the battle for tastes/preferences and comparative price/value relationship has never been more important – those are the causal factors which drive demand.

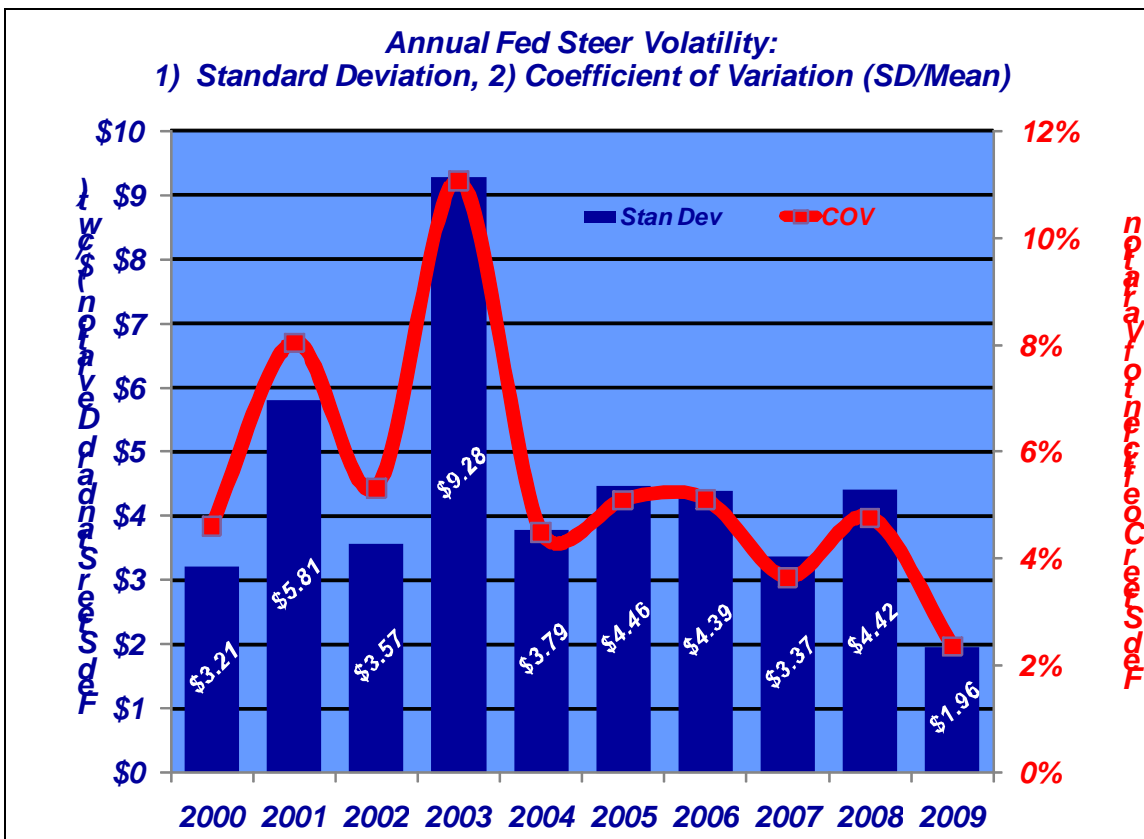
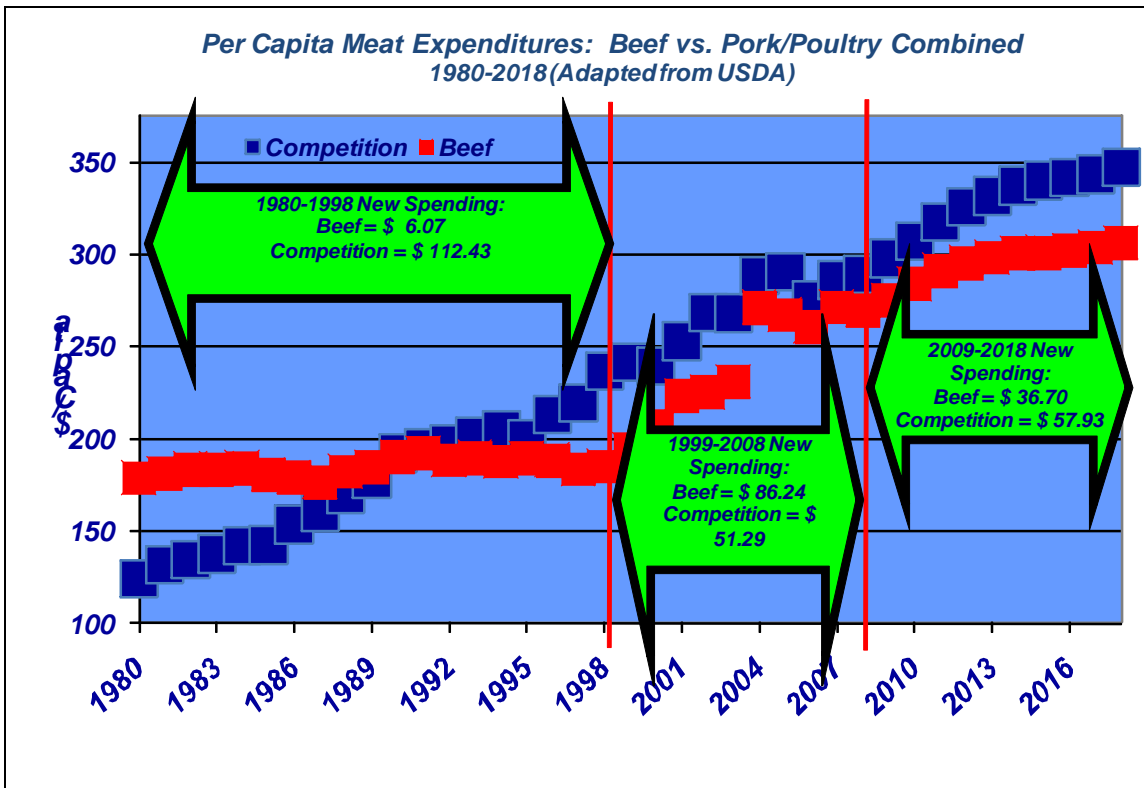
That's particularly tough in this environment - the financial crisis still looms in a significant way. That was most appropriately summarized in the most recent *Main Street Economist*, Federal Reserve Bank of Kansas City (Briggeman and Henderson):

Livestock producers could face another sluggish rebound in U.S. protein demand following the current recession....While economic forecasts suggest the recession is near its end, the prospects of another jobless recovery remain....if unemployment continues to rise even after the recovery begins, limited income gains could slow any rebound in U.S. protein demand. Moreover, unlike past recessions, the contractions in expenditures during the current recession could be an ominous sign of steeper contractions going forward. With the prospects of weak domestic demand for protein, the rebound for the livestock industry may hinge on global protein consumption.

Meanwhile, global markets continue to frustrate per Taiwan's recent ruling banning importation of all ground beef and offals from the U.S. The move is a sharp relapse in efforts to penetrate international markets and bolsters other countries searching for pretext which avoids free trade.

One final observation relative to captive supplies. For detractors, market volatility serves as an important indicator of insufficient market test. The argument goes like this: prices are not subject to fundamental market conditions but rather overwhelmingly dictated by non-negotiated commitments from week to week and thus artificially inflates inter-week negotiations. The last graph provided below depicts volatility in 2009. DOJ's series of workshops during 2010 will "explore competition issues" (never mind previous efforts – for another time). Given the pragmatic evidence and current demand scenario, the beef complex would be better served by government efforts to address the bottom-line: individual wealth and consumer activity. We'll pick up on the economy and beef expenditures next month.





PRICE SUMMARY**WEEK ENDING:**

	8-Jan	1-Jan	25-Dec	18-Dec	11-Dec
Slaughter Steers (\$/cwt)	84.17	84.12	82.04	80.81	79.20
Choice Cutout (\$/cwt)	140.23	139.06	138.51	138.63	136.09
Select Cutout (\$/cwt)	134.97	133.16	131.10	130.83	129.24
Hide and Offal (\$/cwt)	9.31	9.54	9.51	9.52	9.51
USDA Slaughter Weights (lb)	1297	1301	1304	1305	1302
USDA Steer Carcass Weights (lb)	841	843	850	853	852
CME Feeder Cattle Index (\$/cwt)	94.90	94.65	92.56	93.96	92.42
Cow Cutout (\$/cwt)	115.63	112.67	109.64	106.89	104.88
Corn (basis Omaha: \$/BU)	3.99	3.90	3.85	3.65	3.66
Cattle Harvest (000 head)	637	526	465	623	618
Beef Production (million lb)	494.7	410.2	364.2	487.6	481.4