

MONTHLY MARKET PROFILE: OCTOBER, 2009
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Have you ever fed a large group of hungry cows in the mud? If so, you know how futile that can seem. Rather than stopping to eat in a systematic manner, the cows often chase the truck or tractor - all the while they end up trampling the hay into the mud about as fast as you put it out. And you probably find yourself wondering if you're ever going to get far enough ahead of them to actually put some feed down.

The analogy isn't perfect but the feeling of futility might be tangible. Just about the time it appears there might be some promise of better prices, or at least the establishment of firmer footing, the market gets trampled back to lower levels. The past month demonstrates there's much work ahead and sustainable recovery will likely possess more semblance of feeding hay in the mud (messy, disorderly and, at times, frustrating) than pulling up to the bunk in a feed truck.

Labor Day's wait-and-see, tenuous attitude clung to weekly negotiations throughout September. As noted in last month's MMP, weakness stems from broader concerns about the direction of the overall economy. And such concerns are most readily evidenced by the wholesale beef market. The Choice cutout has oscillated between \$135 and \$145 all summer but took a markedly negative turn during the end of September (see the first chart below) - with the spot price actually falling below \$135 for the first time since early-April.

The fed market's inability to seasonally work higher is the direct outcome of softness in the wholesale market. The second illustration highlights divergence of 2009. Normally, the expectation would be for a move to higher levels coming out of summer. Perhaps most troubling, though, is the continued modification, to the downside, at the CME. The October contract has yielded \$10 since mid-July; December has relinquished nearly \$7 during that same time frame and certainly isn't a picture of overwhelming bullishness given that it now stands only a couple of bucks ahead of current spot prices.

Where does that leave us? As noted last month, there's lots of heavy lifting ahead. Alternatively, I've heard the economic recovery being described as "slow motion". Most interesting to me, though, was an article in the most recent issue of *Advisors Perspective* (Oct 6) entitled, "Retailers Face the New Frugality". Author Robert Huebscher notes that consumer spending has dropped dramatically below historical trend and is forcing all types of retailing outlets to adapt. That's hit all industries, including agriculture - the publication included some perspective by James Wright, CEO, Tractor Supply Company (TSC). TSC has worked hard to reduce administrative, distribution and inventory costs but Mr. Wright points out that, "Until we see more clarity on the macro issues, we are taking it slower on growth." And that's precisely the point, it's very difficult right now to get much clarity on the macroeconomic picture - a principle which impacts every industry...including the beef complex.

Multiple times during the past year I've addressed the issue of declining revenue available to the production sector within the beef industry. That's a key consequence stemming from the financial crisis driven from a variety of sources. I outlined the issue in January like this:

Most importantly, that response indicates a spending slowdown across the consumer front. And as noted last month, the spending trough may prove to be deep and enduring as consumers retrench while undergoing fundamental transformation relative to their purchasing habits. Consumer behavior is especially important as it relates to food expenditures. The beef complex is not immune to that effect from both perspectives: volume (less beef being purchased) and value (trading down when purchasing). That's an important influence (both domestically and globally) because it means less overall revenue available to the industry.

The outcome possesses implications throughout the industry no matter your role.

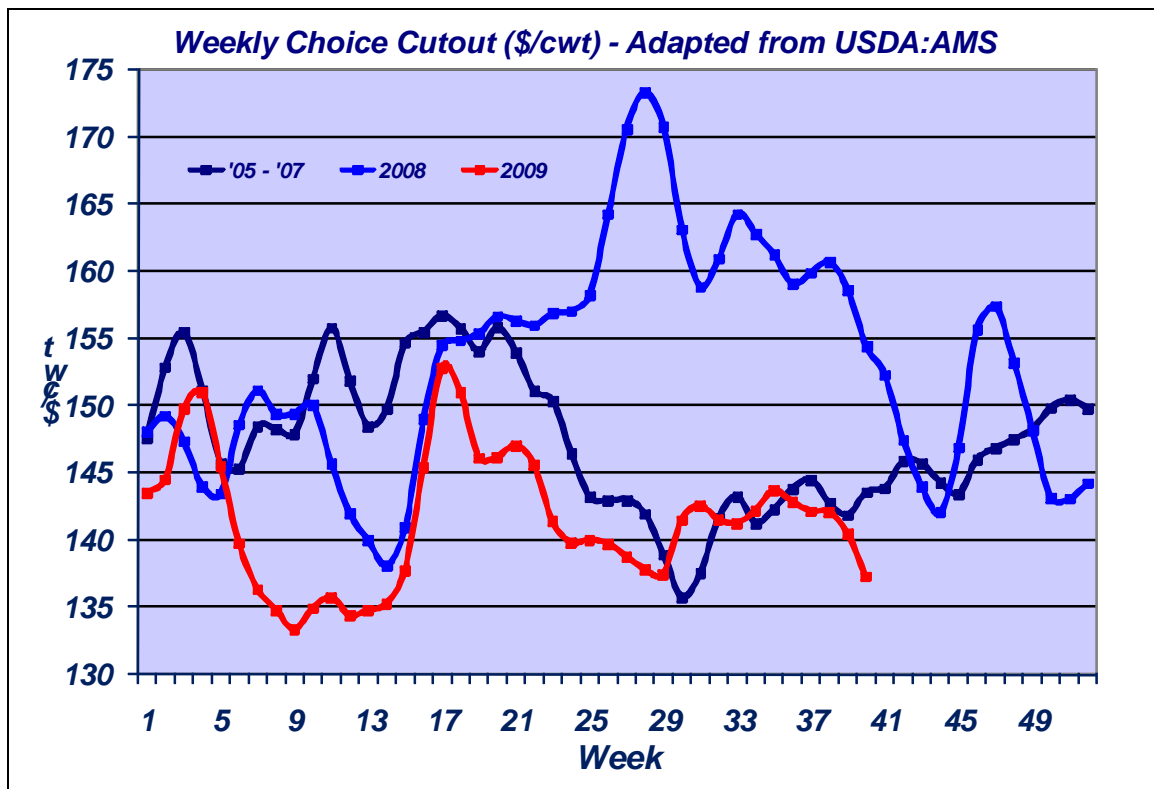
Along the way I've also provided a graph which depicts the revenue trend at the last stage of the production sector's value chain – the feedyard. The third graph below illustrates estimated aggregate revenue for the feeding sector. Clearly, the trend is not favorable! For the year, through August, the production's top-line mark is off 10% compared to the 5-year average. That's equivalent to approximately \$1.65 billion – or \$2.5 billion annually. Admittedly, part of that shortfall has been compensated for by heavier weights (And partially explains cattle feeders' desire to keep on adding weight – it avoids assuming new risk associated with the swap while creating additional revenue. But that's another story for another day.)

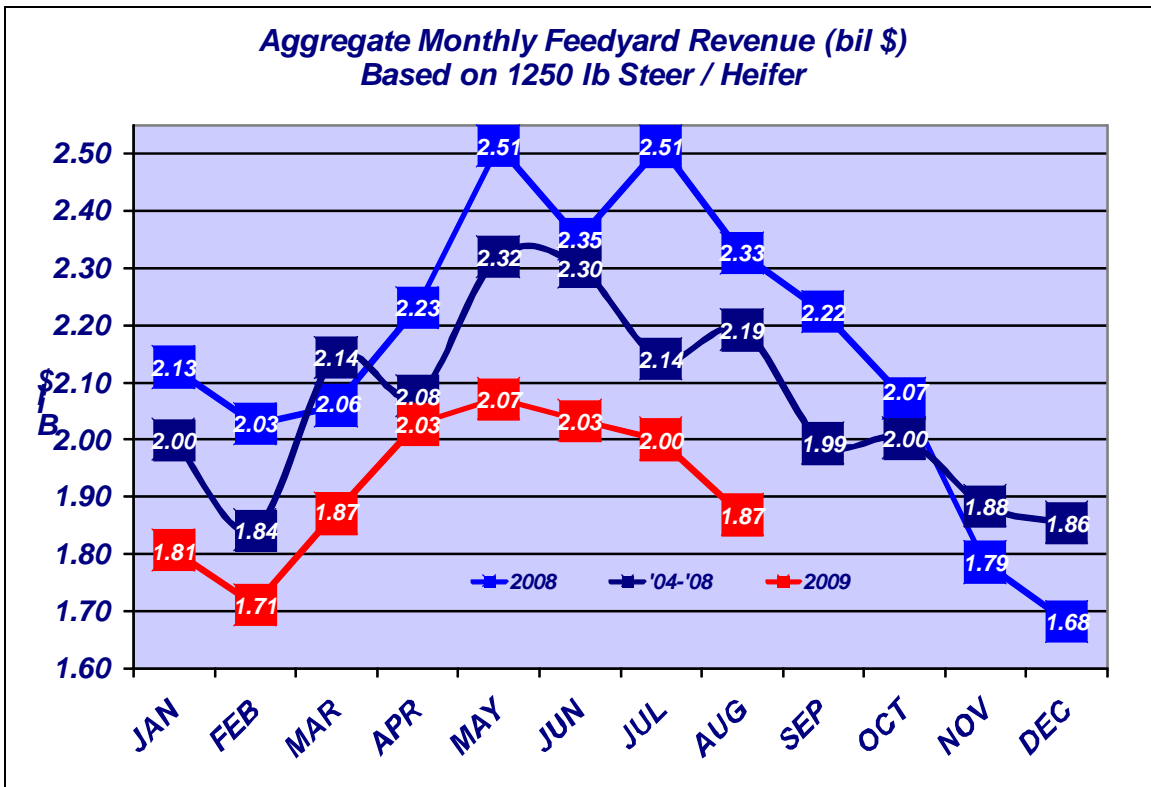
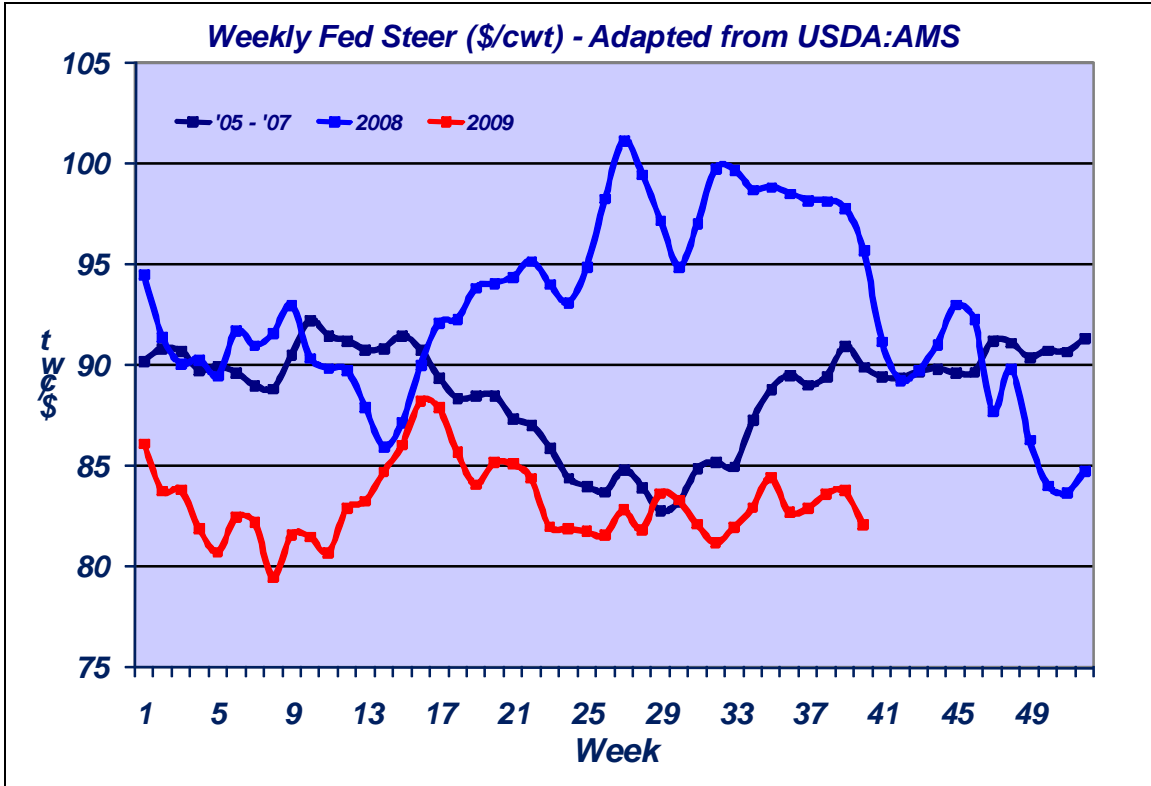
The bottom-line, though, is that cash availability for the feeding sector has declined significantly. And that's especially important when working within a business that inherently possesses already-slim margins. Ultimately, diminished cash flowing into the feedyard gets translated back upstream – all the way to the cow/calf sector.

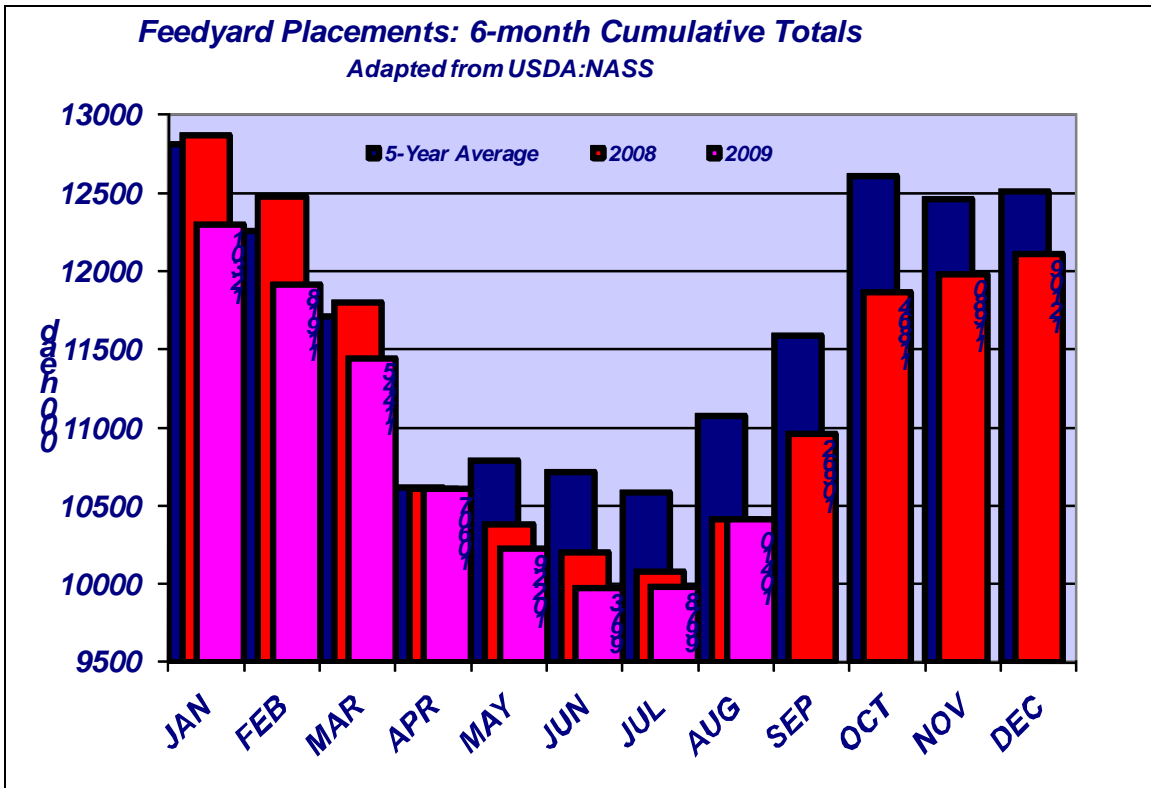
What's especially critical here is the wager that played out, somewhat inexplicably, in August. While feedyards are experiencing an unprecedented string of losses, feedyard managers have seemingly found renewed vigor in terms of risk tolerance. That is, the sector has been relatively aggressive purchasing new replacements in recent months. More specifically, the 6-month placement rate (roughly one turn of cattle) is nearly equal to last year's pace while marketings are approximately five-percent behind 2008.

And so feedyards have doubled down. One of two outcomes will occur. Favorably, they'll finally find some reward for betting on the come. An outlook for cheaper corn and hopes for improved economic conditions will pay off handsomely. Alternatively, heavier weights, bigger supply and continued sluggishness will not only hamper but likely confound the market. The outcome? Potentially sharp leverage decline for cattle feeders amidst weekly negotiations.

It's a showdown – how the cards play out remains to be seen. Either way, the final quarter of 2009 and the first quarter of 2010 may prove to be VERY significant.







PRICE SUMMARY

WEEK ENDING:

	2-Oct	25-Sep	18-Sep	11-Sep	4-Sep
Slaughter Steers (\$/cwt)	82.08	83.77	83.57	82.89	82.69
Choice Cutout (\$/cwt)	137.25	140.48	142.04	142.12	142.83
Select Cutout (\$/cwt)	131.91	133.76	134.29	134.13	135.20
Hide and Offall (\$/cwt)	8.21	8.84	9.25	9.46	9.46
USDA Slaughter Weights (lb)	1311	1305	1299	1297	1296
USDA Steer Carcass Weights (lb)	867	869	861	858	855
CME Feeder Cattle Index (\$/cwt)		95.96	97.93	98.91	98.95
Cow Cutout (\$/cwt)	102.32	103.46	103.09	103.66	104.25
Corn (basis Omaha: \$/BU)	3.21	3.17	3.03	3.10	3.03
Cattle Harvest (000 head)	635	650	648	562	655
Beef Production (million lb)	504.4	513.9	510.0	442.6	515.8