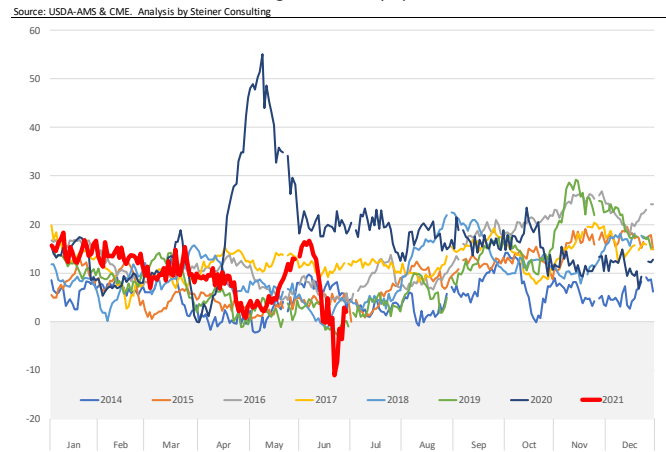


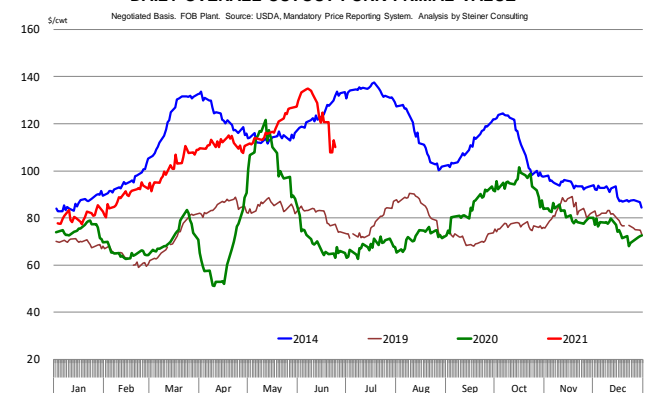
Lean hog futures rebounded yesterday, with the July contract up by more than 200 points from the day before. Other contracts were up as well. The big discount of the July contract vs. the CME Lean Hog index (\$7 on Monday), and expectations for higher cutout values next week, may have contributed to the big gains for July. The situation in the cash hog market has reversed quite dramatically compared to a week ago. The \$11 discount of the cutout to the CME Lean Hog Index was unusual and short lived. However, packer margins remain constrained and the meat margin (spread between cutout and hog values) is close to zero at this point. Does the spread really tell you the profitability situation? It has been always hard to talk about margin levels in the hog industry given the myriad formulas and ways in which packers price hogs. Export sales and offal/by-product value are other components of the profitability picture that differ greatly from packer to packer. Additionally, the decline in slaughter also tends to impact operational efficiencies and packers continue to struggle with holes in processing lines and uncertain labor schedules. Depending on the hog price benchmark that one picks for the margin calculation, one can end up with different results. For the week ending June 26, for instance, USDA reported lean hog carcass prices in a range of \$99 - \$122 (LM_HG214 report). The net average price of producer owned hogs sold last week was \$109.74 vs. the average pork cutout value of \$111.89. So while the cutout discount to the CME Lean Hog index looks quite dramatic in the attached chart, we are not sure how instructive that is with regard to packing profitability. One should also be aware that even if we picked the perfect hog market benchmark to measure against the cutout, they are still at best directional indicators. About 38% of the hogs slaughtered last week were packer owned, a figure that is consistent with the YTD figure. In short, use the spread charts like the one above as a very rough gauge, recognizing the shortfalls.

There is a fair amount of debate about the outlook for the cutout in the near to medium term. With a long holiday weekend ahead of us, packers and end users will be very careful both in terms of slaughter and orders so as to avoid any shelf life issues. It is not a coincidence that bellies and hams were down yesterday despite the lower slaughter as processors need to manage workflow over the long weekend. Next week will be a short slaughter week and both retailers and processors will be back in the market. This should be supportive of the cutout. Carcass weights of producer owned hogs have declined by 5 pounds or 2.3% since early June, which should also limit supply availability in July. The big unknown at this time is the consumer response to the wave of price increases that have been filtering through, both at retail and foodservice. The pork cutout has declined by \$19/cwt or 14% since early June, in part because of end user pushback to higher prices but also because of waning holiday demand. As the chart to the right illustrates, a number of items contributed to the decline, with bellies leading the pack. The broad based declines, and the potential for more downward pressure on shoulder cuts due to weaker exports, present more downside risk for the market in July and August.

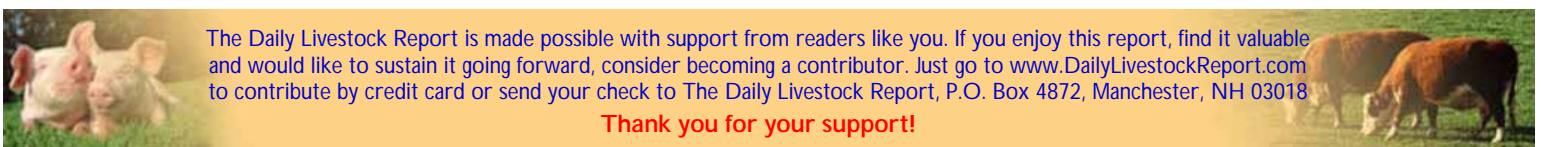
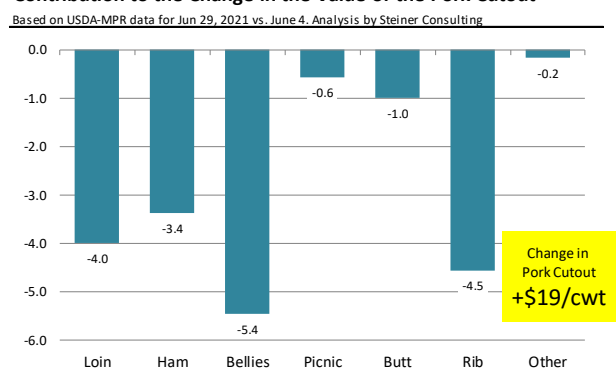
Pork Cutout minus CME Lean Hog Index. Daily Spread. \$/cwt



DAILY OVERALL CUTOUT PORK PRIMAL VALUE



Contribution to the Change in the Value of the Pork Cutout



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