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In The Cattle Markets

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The Impact of Basis in Fed Cattle

A relationship sometimes overlooked but important to the flow of cattle is the difference between the cash and futures price or the basis. For example, at the end of last week, the 5-area weekly weighted average cash price for all grades of live steers was $101.73. The nearby fed cattle futures price averaged $97.76 last week which was for the October contract. Thus, the average basis was +$3.97.

Changes in basis influence returns from hedging using the futures market. Hedgers swap price risk for basis risk and for those selling cattle, a positive basis means more money. Using a simplified example, assume a manager purchased a group of steers in March 2019 with plans to feed for 6 months and immediately hedged by selling an October 2019 Live cattle futures contract which was trading at $116 at the time. After that point, prices going down helps them in their futures position but hurts them in their cash position – hence they are hedged against the impact of price changes.

If this manager sold their steers last week and offset (bought back) their futures contract, they would have made $18.24 per CWT in the futures market ($116 - $97.76 = $18.24) but of course their cash cattle were worth much less than they were in March and they sold them for only $101.73 per CWT. Adding the $18.24 made in the futures market to the $101.73 from selling the fed steers and this manager earned $119.97 per CWT for the steers. This is $3.97 more than the futures price "locked-in" back in March ($119.97 - $116 = $3.97). This improvement over the locked-in price is due to the positive basis last week.

Ok, that's enough textbook stuff – why does this matter? Live cattle basis has been positive since mid-April 2019 using weekly nearby futures averages and weekly fed steer averages. This means that hedgers closing out in these weeks generally took home more than what they originally "locked-in." Conversely, from September 2018 through March 2019, basis was negative for 28 out of 32 weeks which means hedgers generally took home less than their lock-in price. This shows that there is still risk in hedging – but the range (distribution) of basis risk is usually not as wide as the range of price risk.

Strong basis can help pull cattle through the supply chain even at low prices because producers who hedged their cattle want to take advantage of the additional revenue that larger basis provides. That is likely the case in recent weeks even as fed prices have deteriorated.

The Markets

Data Source: USDA-AMS Market News		**Week of 9/6/19**	**Week of 8/30/19**	**Week of 9/7/18**
5-Area Fed Steer	all grades, live weight, $/cwt	$101.73	$105.59	$107.67
	all grades, dressed weight, $/cwt	$165.83	$171.52	$170.25
Boxed Beef	Choice Price, 600-900 lb., $/cwt	$229.51	$234.35	$209.13
	Choice-Select Spread, $/cwt	$22.76	$22.50	$9.62
700-800 lb. Feeder Steer	Montana 3-market, $/cwt	$139.50	$144.14	$151.72
	Nebraska 7-market, $/cwt	$151.04	$151.22	$165.69
	Oklahoma 8-market, $/cwt	$138.78	$140.67	$153.79
500-600 lb. Feeder Steer	Montana 3-market, $/cwt	--	$150.00	$180.00
	Nebraska 7-market, $/cwt	$166.68	$165.29	$174.18
	Oklahoma 8-market, $/cwt	$141.54	$149.47	$159.44
Feed Grains	Corn, Omaha, NE, $/bu (Thursday)	$3.59	$3.70	$3.33
	DDGS, Nebraska, $/ton	$137.50	$131.50	$132.50