

In The Cattle Markets

Matthew A. Diersen, Professor and Extension Specialist
Department of Economics, South Dakota State University

Spot, Futures and Forward Markets

Seasonality is often discussed in terms of a consistent pattern in cash prices. In the northern plains the cash or spot price for fed cattle has an April or May peak with a September or October low. Such patterns are also consistently observed in forecasts and futures prices. In addition, the forward contract market may provide some insights into intervening months. Can such patterns be used when making marketing or risk management decisions? The answer depends on how much stock one puts into the different prices and what patterns are expected to hold going forward.

Consider the seasonal pattern implied by recent live cattle futures prices. The nearby October 2018 contract is trading at a steep discount to the next few contracts. The prices peak with the April 2019 contract before breaking sharply for the deferred contracts. The implied pattern weakens as one moves into the 2020 contracts. The general pattern is not inconsistent with the observed seasonal pattern in cash prices. If the futures contracts were not reflecting a higher price level for April, one could wait to hedge or not do anything, expecting a better eventual price in the spot market. Likewise, if the futures price for February was reflecting a strong premium compared to other months, it could be used to hedge at a likely premium to the eventual spot price.

Now consider the seasonal pattern in the latest World Agricultural Supply and Demand Estimates. The projected price ranges for the first three quarters of 2019 for slaughter weight steers are \$117-125, \$118-128 and \$109-119. Thus, seasonally the prices are expected to increase until peaking in the second quarter and then falling off sharply into the second half of the year. Throughout the projection period, the projected low (high) price is generally lower (higher) than the futures price. Thus, there is not much discrepancy to suggest that the futures may adjust reflecting fundamental forces or that any additional convergence may occur. If the futures were higher than the projection range, they could be signaling to hedge. If the futures were lower than the projection range, then a hedger could wait in expectation of a favorable price change.

Another market that shares features of both the spot and futures markets is the forward market. The Agricultural Marketing Service report titled Packer Owned Cattle, LM_CT153, shows the volume of head and basis levels for cattle traded in the forward market for the prior week. Either the weighted average basis or the most common basis for a given delivery or futures month may give additional insight into when or if a different seasonal peak is expected. In a way, the forward information may allow one to refine price expectations. For example, forward contracts for March 2019 recently traded with an average basis that was positive relative to the April contract, suggesting that seasonally the eventual spot price may

be higher in March than in April. The smaller negative basis for May compared to June, for forward contracts tied to the June futures prices, also suggest prices may decline from April into June.

The Markets

In the cash market, fed cattle traded lower for the week. Feeder cattle also traded lower, with variation across weights and locations. Feed prices were higher for the week. Both live and feeder cattle futures prices traded lower for the week. The implied volatility remains low in both markets, with an emerging spike in deferred live cattle out-of-the-money put options. Regionally, after low trade volume of lighter feeders during the summer and early fall, there have been larger runs in recent weeks of calves at higher than expected prices. The supply of feeder cattle outside of feedlots will be a key indicator to monitor going forward.

<i>Data Source: USDA-AMS Market News</i>		Week of 10/12/18	Week of 10/5/18	Week of 10/13/17
5-Area Fed Steer	all grades, live weight, \$/cwt	\$110.52	\$110.95	\$111.01
	all grades, dressed weight, \$/cwt	\$173.52	\$174.83	\$174.96
Boxed Beef	Choice Price, 600-900 lb., \$/cwt	\$202.68	\$204.30	\$197.50
	Choice-Select Spread, \$/cwt	\$10.46	\$11.37	\$8.11
700-800 lb. Feeder Steer	Montana 3-market, \$/cwt	--	\$171.70	\$161.57
	Nebraska 7-market, \$/cwt	\$164.57	\$164.82	\$169.42
	Oklahoma 8-market, \$/cwt	\$155.57	\$162.51	\$159.25
500-600 lb. Feeder Steer	Montana 3-market, \$/cwt	--	\$175.79	\$175.74
	Nebraska 7-market, \$/cwt	\$187.29	\$187.62	\$184.33
	Oklahoma 8-market, \$/cwt	\$161.09	\$165.75	\$158.49
Feed Grains	Corn, Omaha, NE, \$/bu (Thursday)	\$3.27	\$3.20	\$3.09
	DDGS, Nebraska, \$/ton	\$141.50	\$135.00	\$116.30