CAB® Insider

April 4, 2018

MARKET UPDATE

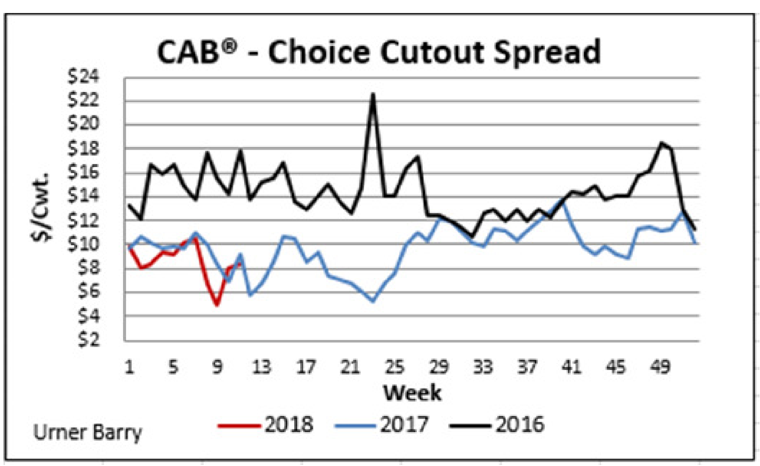
by Paul Dykstra

The fed cattle market finally fell last week in reaction to all of the bearish sentiment resulting from large fed-cattle supplies slated to harvest in the 2nd quarter. The 594K head count was smaller due to some packing facilities being closed in observance of Good Friday.

After noting recent record supplies qualifying for the *Certified Angus Beef®* brand, we have seen that trend continue: 7 weeks in a row with CAB acceptance rates above 35%, or twice the historical average prior to this decade. The latest week of March 18th tallied 106,670 certified carcasses. Fed cattle supplies from now until the end of the fiscal year will likely sustain those weekly averages higher than 100K.

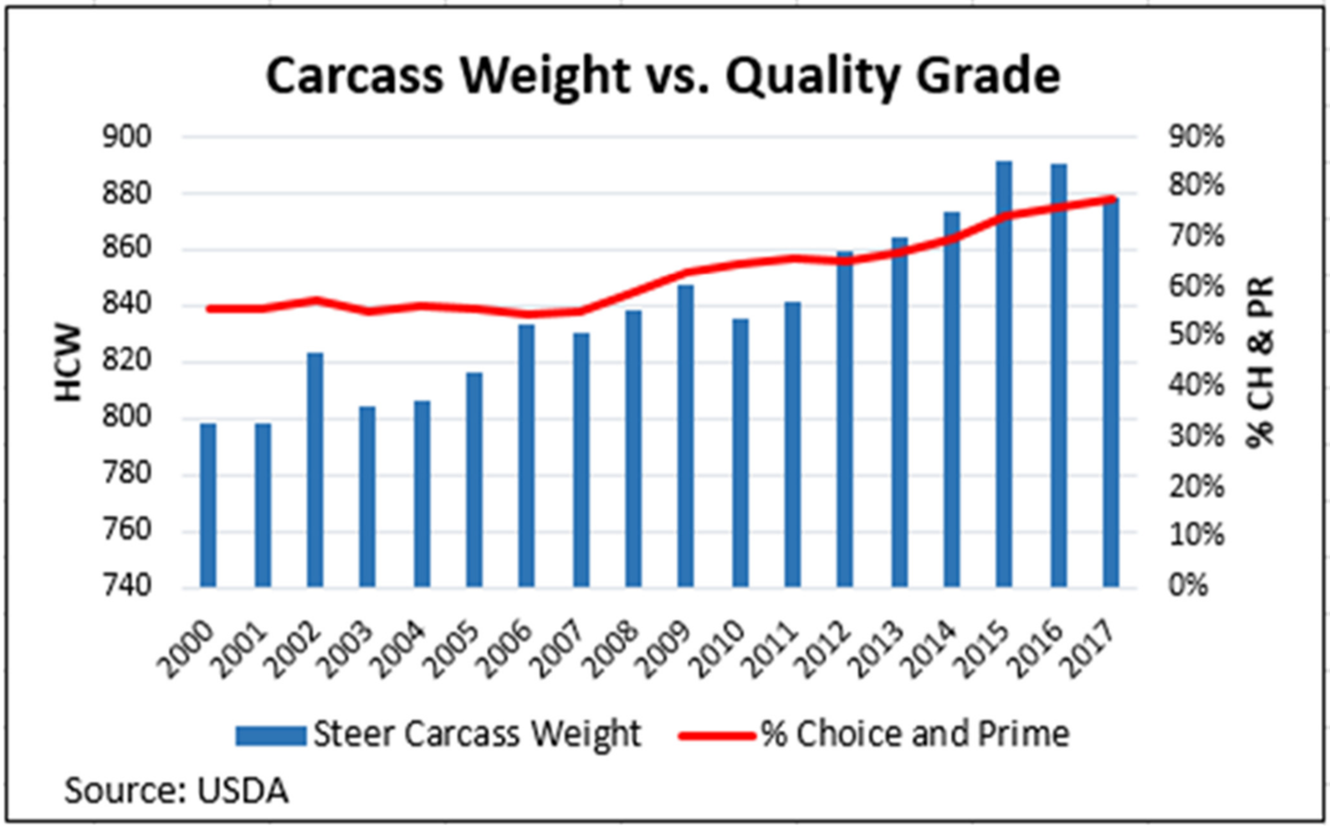
URNER BARRY	This Week	Previous Week	Previous Year
Weekly Slaughter	594K	607K	601K
Fed Cattle Price	$121	$126	$129
Steer Carcass Wt.	877	881	881
CAB cutout	$230.30	$231.80	$219.30
Choice cutout	$221.20	$222.70	$206.50
Select cutout	$213.70	$215.70	$199.60
CH/SE spread	$7.50	$7.00	$6.90
CAB/CH spread	$9.10	$9.10	$12.80
Beef Index	$219.80	$221.30	$204.00
Pork Cutout	$70.90	$73.20	$75.00
Chicken Index	$73.90	$72.70	$77.10

With Easter behind us, we will again see beef as a focal point in the market and move into further buying for the grilling season ahead. Last week's average prices show slight declines, with CAB and Choice cutouts lower by $1.50/cwt. and Select down $2/cwt., according to Urner Barry. The Choice/Select price spread has a strong seasonal tendency to widen now through early June, with grilling season and steak demand placing buyer preference on higher quality, richly marbled product. The CAB cutout price spread above Choice does have sensitivity in the spring with some demand-driven spikes (see the 2016 line). But with the share of certified carcasses set to be quite a high proportion of total fed cattle production, it is more likely for the CAB/Choice spread to remain in a lower range this spring, perhaps around $8 to $10/cwt.



In subprimal sales from Easter week, we see buyers pulling back in line with expectations for the period, prior to gearing up in mid-April to buy for grilling season. As such, CAB rib prices fell back by almost $8/cwt. last week with apparently adequate supplies in the spot market. Although not a certainty, we could expect rib prices to stall or decline into mid-April. The loin complex moved just slightly higher last week with strips at a discount of $1/lb. compared to a year ago, but they stand to add price moving forward. Top sirloins should also be considered a buy opportunity at a $3.48/lb. discount, 15% lower than a year ago while PSMO tenderloins are

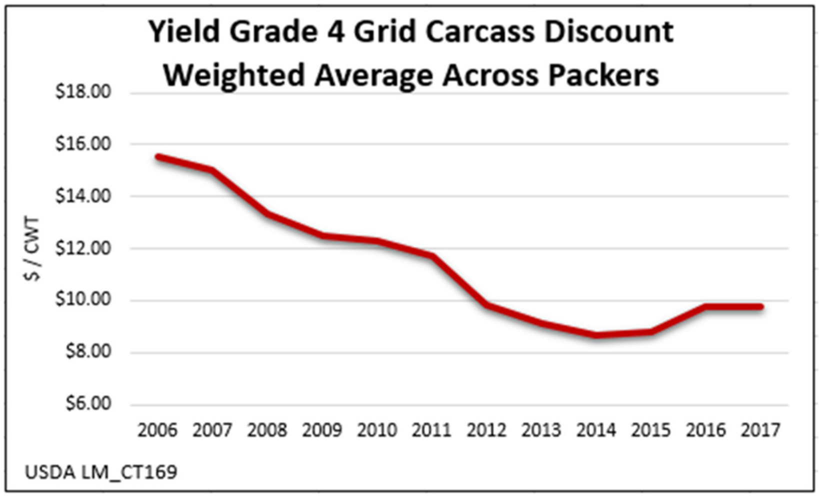
8% cheaper than in 2017. The chuck and round complexes provided very little direction last week, both declining just slightly but essentially unchanged. While they don't weigh much, the outside skirt is underpinning carcass value to the extent that it can with a $7.68/lb. price 40% higher than a year ago at this time. That spring price trajectory is occurring earlier and higher than in recent years. Alternatively, inside skirts at $4.79/lb. are 5% cheaper than a year ago. CAB grinds were priced a bit weaker and remain at or below year-ago prices. ###



Beef industry, consumers make peace with fat

In early March, we focused on Yield Grade (YG) premium and discount structures on different packer-grid marketing arrangements. Today let's look at how packers have changed grid pricing relative to YG and carcass weight and how those moves have directly promoted marbling, quality grade and overall product-acceptance by consumers. Looking back into history we know that the beef industry had declared a "War on Fat" in the 1980s as consumers accepted the questionable science of the time suggesting that (all) fat, as a nutrient, was bad for human health, increasing our own body fat and causing elevated cholesterol. Beef producers followed the resulting shift in market demand by breeding and managing cattle to an endpoint delivering less external carcass fat to the packer and numerically lower YG while marbling levels suffered the fallout.

Fast forward to the 21st century, and many have come to realize the fallacy in that War, that consuming fat in moderation is a necessary component of a healthy diet. Furthermore, the beef community has embraced the idea that marbling promotes tenderness, juiciness and flavor as perceived by beef consumers. Packers have long incentivized marbling in beef through premiums for Choice and Prime quality grade as well as CAB brand premiums. They have also indirectly promoted richly marbled carcasses through removal of some of the YG 4 discount burden. That move has allowed genetic selection of Angus cattle and feedlot management to optimize external fat content in a pen of fed cattle alongside the target mix of Choice, CAB and Prime carcasses.



As seen in the line graph, in 2006, the industry-average $15.53/cwt. discount on a YG 4 carcass was a major hit to the bottom line. That's why cattle feeders managed production to market cattle before a pen would average anything north of 8% or certainly 10% YG 4s. At that time, leadership within CAB noted too many high-quality carcasses failed to receive the CAB label due to the specification that, at the time, only allowed YG 1-3 carcasses. Replacing the YG specification with components of its formula (ribeye size, backfat thickness and carcass weight). The individual specifications opened the door for YG 4 or higher carcasses to qualify, provided all required measures were met through the closely-trimmed final product standards adopted by packers in that era.

The ensuing tide of consumer demand for highly marbled beef has prompted packers to slowly decrease their YG 4 discounts over time as seen in the data, beginning with the first USDA reports for grid pricing in 2006. The price signals have led us at all points along the production chain to select Angus cattle with a more refined balance of external fat, marbling and muscle, while cattle feeders can feed a pen of steers or heifers to a degree of external fat and internal marbling that deliver a high-quality product demanded by consumers worldwide.

Escalating carcass weights have also played a role in promoting higher marbling levels. That weight trend spans several decades, and packers have increased their maximum carcass weight threshold along the way. The point at which the 2017 industry-average $23/cwt. discount is triggered was moved up from 1,000 to 1,050 lb. in 2014-15, when cattle supplies were very tight and weight per head was an important feature. Some packers went further, imposing only a small discount for weights between 1,050 and 1,075 lb. That move was supply related, but we recognize that increasing days on feed became achievable as carcass-weight "heavy" thresholds were elevated, creating opportunity for more marbling deposition in the process.

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