WEEKLY OUTLOOK

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HOG PRICES GO UP FROM HERE!

Hog producers have been feeling the bite of losses once again this fall, but there is reason for some optimism. First, hog prices are probably at their seasonal lows in late November as consumers are buying their Thanksgiving turkey rather than pork. Second, lower corn and meal prices provide an opportunity to lock in feed prices at levels that were not available a few weeks ago. The 2011 outlook also provides some optimism for a year of positive margins on average. Producers may want to consider taking some of those positive margins now.

Live hog prices fell from near $60 per hundredweight in September to the mid-$40 by mid-November. With costs of production in the mid-$50s, this means losses near $15 per head in the final quarter. The saving grace is that profits were strong last spring and summer. Those profits will offset current losses and result in an estimated 2010 yearly profit of $14 per head.

Why will prices rise after Thanksgiving? Hog prices still have substantial seasonality even though much of the supply variation across the year has been removed. Over the past five years, hog prices reached highs in the warm weather months of May through August, and lows in November, especially the last-half of November. After Thanksgiving, hog prices have tended to rise slowly into mid-February and then dip modestly into early-April before moving to highs in May and June.

This pattern of generally rising prices is expected into next spring and summer. Live prices are expected to average near $50 in the final quarter of this year and then move higher into 2011. First quarter prices are expected to average near $55 per live hundredweight with second and third quarter prices stretching to $62 and $61. Last quarter prices are expected to drop to the mid-to-lower $50s. These hog prices are derived as forecasts of cash prices from current lean hog futures, which means these prices can be hedged by pork producers.

While lean hog futures are relatively optimistic at the current time, feed prices have also dropped, providing profitable margin opportunities for 2011. Taking margins can be accomplished in the futures market by selling lean hog futures for 2011 and buying corn and meal futures, and then later converting these to cash positions. Margins can also be taken in the cash market or through combinations of futures and cash positions.

Current estimated returns per head by quarter in 2011 are -$4, +$14, +$16, and +$1 for an average near $7 per head for the year. It is clear that the second and the third quarters are where the money will be made, with the first and fourth quarters closer to breakeven or a small loss. This reflects the seasonality of hog prices with higher hog prices in the warmer weather months providing the greatest profitability.

The last calendar year of extremely high corn prices was 2008 when the simple average of U.S. monthly prices received by farmers was $4.78 per bushel. For 2011, the forecast is $4.87 per bushel based on corn futures prices before the opening on November 22. The year of 2008 was a loss year of nearly $17 a head for farrow-to-finish production. The difference for 2011 is much higher hog prices after substantial herd reduction from 2008 to 2010. Live hog prices are expected to average near $57 in 2011, $10 higher than in 2008.

The decision of when, and how, to take hog margins will be made by each individual producer. One of the most important criteria producers seek is to take margins when they are profitable. That criterion is now available for 2011.

Let’s look a bit more closely at each of the three legs of the hog margin puzzle: corn, meal, and lean hogs. Corn prices have moderated from highs made on November 9. Ending stocks are expected to be very tight and any added demand or supply reduction could send prices sharply higher. World corn and feed grain supplies cannot be re-established to adequate levels until the northern hemisphere crop is assured next summer, and that is probably late-summer. Meal prices have moderated as well. World soybean inventories are not in a tight situation, but that will depend on how many bushels China buys and on South America having normal or better yields. Lean hog futures for April through August are at, or near, their 2010 highs.

Producers unwilling to take large financial risk may want to establish a sizable percentage of their 2011 margins at what appears to be profitable levels. If using futures markets, they must work closely with their lender on potential margin calls.

The charm of having three major legs of the hog margin is that producers can establish all or just some of those legs. Some hog producers are more concerned about feed prices than hog prices. For them, the current corn and meal prices may seem more advantageous to establish. Others produce their own corn and have it in storage. For them, establishing portions of their meal costs and hog prices may be more important.

Many producers seek market diversification. This can mean taking a portion of the margin at several different times. Often they seek to leave at least one-third of that margin open and take whatever comes in the cash market.

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