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TRADING GROUP, LLC

Tuesday, August 13, 2019
NTG Morning Comments
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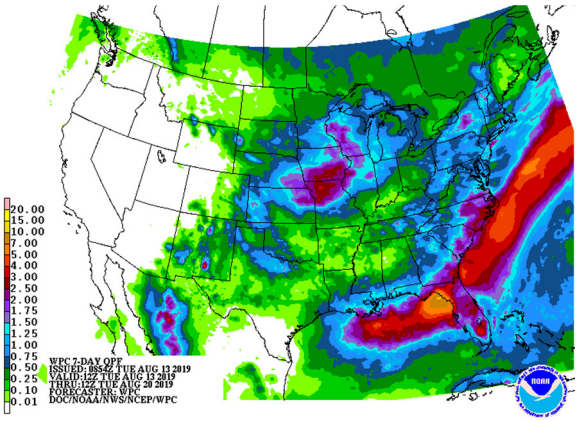
Weather

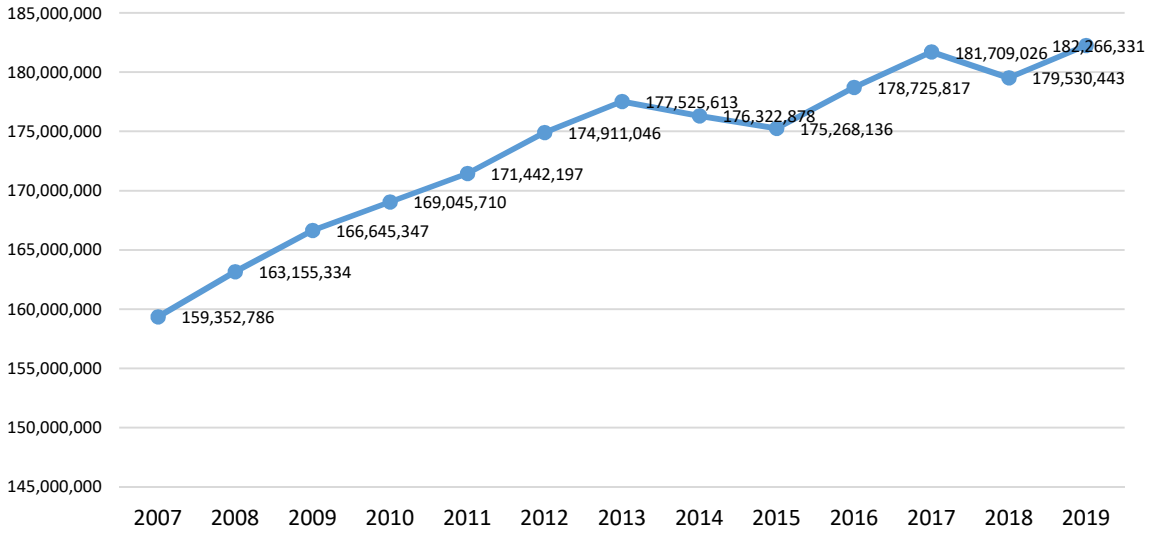


The 7-day QPF shown to the right. As usual, the WPC is likely overstating coverage of rainfall with their map, but the setup appears very favorable for some big rains to be seen especially along the IA/MO border. Note that most of this rain is not going to fall until Thurs-Sat, which means this forecast is still likely to change a bit. The next few days in the Corn Belt should be mostly dry. There will be some spotty areas of light showers, but nothing impressive. Look for precipitation chances to continue in the 6-10 day period, mainly favoring eastern areas with the best amounts. The call for the 11-15 day period is for near-normal precipitation, but the truth is some areas will see AN rainfall and other BN and for now there is just no way to tell who will see what. Temps generally should average fairly close to normal over the next two weeks.

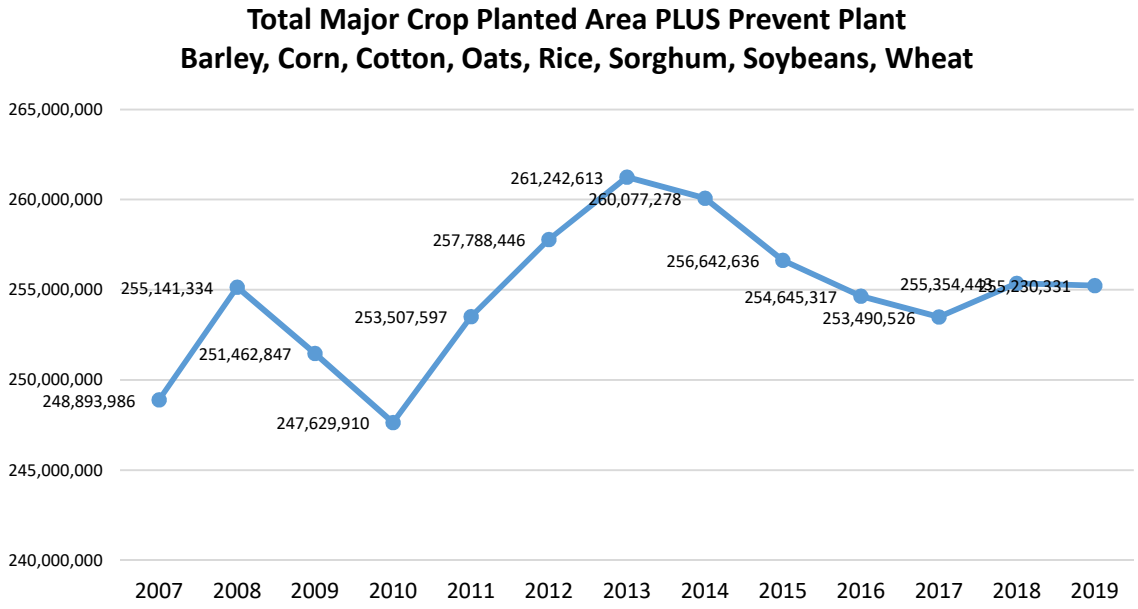
Crops

One question I received a lot yesterday was some variation of – "If corn planted area was ~90 mil and PP for corn was ~11 mil, does that mean the country intended to plant ~101 mil acres of corn this year?" In my opinion, the answer is yes and no. The problem answering the question is that the 101 mil number doesn't really answer a question of "intentions". My thought process is – if you're going to file a PP claim it is best to take it on the crop that will pay the best via PP. I would imagine in most cases that would be corn. So long as you stay within the limits of what you are allowed, you take corn PP on whatever PP acres you plan to file. And, on what acres you actually can plant, you still go with what gives you the best odds for revenue and again that looked like corn. Remember, the spring rally in soybeans didn't come until pretty late. Note the chart below which combines corn and soybean planted area with PP declared for both corn and soybeans. I think NASS's numbers are simply inline with the trend for more corn and soybean area at the expense of other crops.

Total Corn and Soybean Planted Area PLUS Prevent Plant



Looking across all crops, when you take combined planted area with combined PP, it looks like we're looking at a total acreage pie that is pretty similar to last year. That leaves me hard pressed to really find much to argue with in terms of NASS's acreage numbers from yesterday.



I guess my bottom line this morning is that I now consider the acreage question settled. Please don't be "that guy" that continues to run with the "USDA is dumb" narrative. I won't say acreage can't change from here. It almost certainly will change *some*, but past experience tells us big adjustments from this point are unlikely.

Livestock

This morning rather than hearing from me I thought I would pass along some words from my good friend Mike Sands. He is adding some further color on the Tyson plant fire and implications on the LC board:

At the risk of beating a dead horse—or at least a severely ailing one—Monday's futures response to the fire at Tyson's Holcomb, KS, plant may be significantly overdone—at least from a fundamental standpoint, particularly in light of the already strong basis and discount on LCV, which has slipped to about 2 under LCQ and at around $104 is nearly $7 under last week's Southern Plains average near $111 and even $4 under the late-week/post-fire trade at $108. A basis of 2-4 under LCV in mid to late Sep would not be out of line compared to the last couple of years—suggesting that the market seems to be pricing a late summer/early fall low around $100-$102. That's later and lower than the last couple of years; last year's mid/late summer low did reach $106-$107 and in 2017 near $105; 2016 slipped to $98 in October amid massive financial losses and heavy carcass weights, which bear little resemblance to this year. While it is true that fed cattle slaughter supplies in the weeks ahead are slightly larger than 2017 and 2018, carcass weights likely will be lighter and exports larger—as a result domestic fed beef supplies in Sep/Oct/Nov likely will be smaller than last year. And, there is little indication that beef demand will be weaker—thus, lows comparable to the last couple of years—around $105 is not an unreasonable expectation, amid massive competing meat supplies and little relief from continuing trade tensions.

So, doesn't the reduced slaughter capacity in the wake of the fire justify something substantially lower? Perhaps not. The Holcomb plant is estimated around 6,000 daily capacity—but appears to have been operating around 5600-5800 per day. Within reasonable proximity to that plant there are 7 other major slaughter plants;

Tyson –Amarillo at 6,000
Lexington 4,800
Cargill—Dodge 6,000
Friona 4,500
National—Dodge 6,000
Liberal 6,000
JBS—Dumas 6,000

Taken together those plants have nearly 40,000 head daily capacity. For the sake of argument, let's say they are operating at 90% or slightly less of capacity—not an outrageous assumption—we have reached weekly fed cattle volumes this spring in the 535-540k range, which was probably well short of full capacity, and last week was around 520k. It may not be unreasonable to expect that those 7 plants could absorb around 4,000 per day—an increase of about 10% spread across those 7 plants. That would leave about 2,000 a day or 10,000 a week.

The industry has demonstrated several times during the past year that a Saturday kill near 90,000 is attainable. In recent weeks, volumes have ranged around 50,000, so an additional 10-15k on Saturday is doable—at least for a short period of time, given ongoing labor issues.

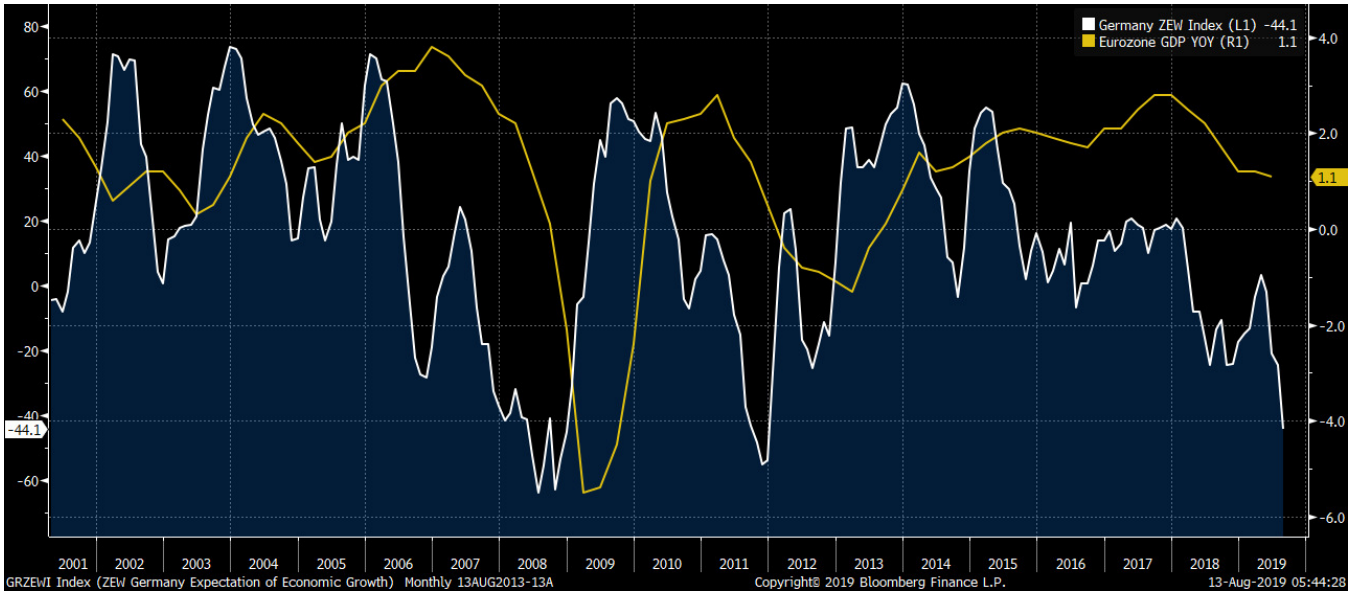
To facilitate the disruption in marketing patterns, perhaps operating margins need to increase; some of that is already under way—cash last week was $1.50 or more lower and the blended cutout at the beginning of the week is up nearly $3 from last week's close—which add $40-$50 per head to operating margins—already well in the black--likely with more increases in the beef as the week progresses.

Obviously, money flow can certainly swamp perceived fundamentals, but from this perspective, Monday's limit decline from already low levels appears to be overdone.

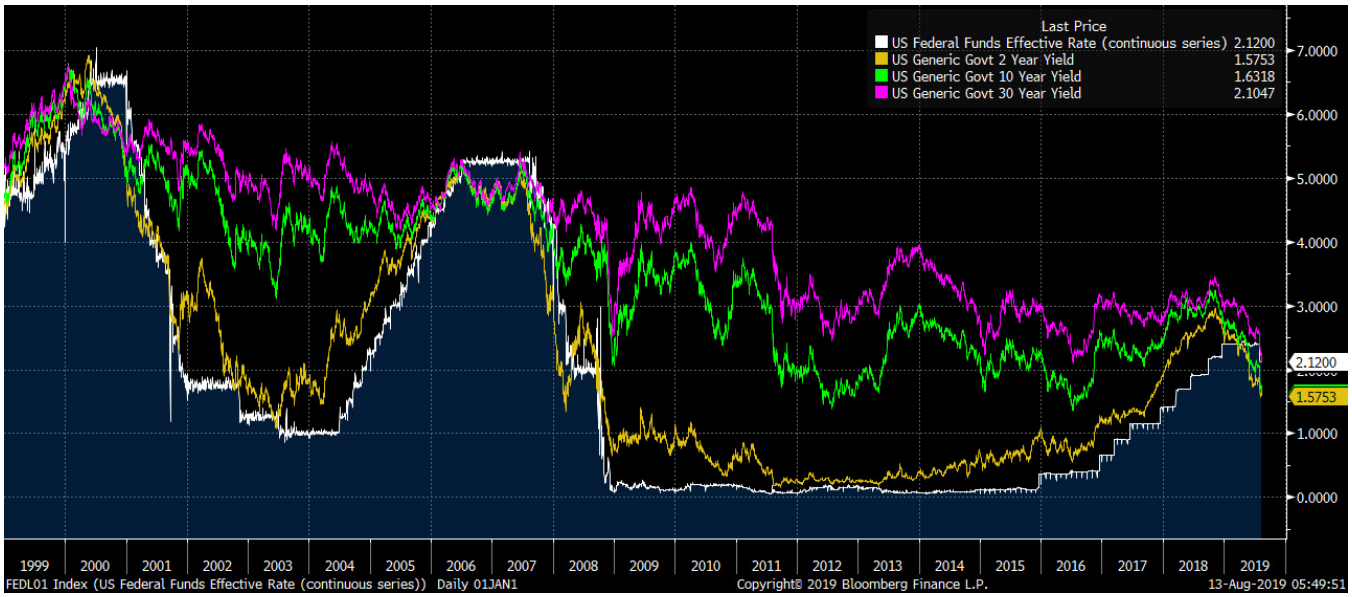
Thanks to Mike for the perspective. Definitely something to think about considering markets should, in theory, open sharply lower again today based on the synthetic levels of trade near yesterday's close. For example, my understanding is LCV was trading near 100 synthetically near the close. LCZ near 105.50.

Financials

There isn't much change in terms of sentiment on headlines this morning. Yesterday we saw Argentina's currency drop 25% and their equity market cut almost *in half* (in USD terms) on the election results. Hong Kong remains a mess this morning with the airport closed again. Overnight some gloomy data from Europe, where the German ZEW investor absolutely fell out of bed posting a -44 reading. This is the lowest reading since the debt crisis back in 2011. Note the chart on the following page, which tracks the German ZEW index vs. Eurozone GDP YOY. I haven't adjusted the timeframes on the chart, but you can see that the ZEW is something of a leading indicator for Eurozone GDP. The recent weakness in the ZEW doesn't portend good things for Eurozone economic performance and is certainly just another negative bit of sentiment to deal with for the moment.



Another chart I think of interest is below, showing US Treasury yields vs. the Fed Funds effective rate. I've shown this before, but notice that as of the time of writing this morning US 30s are now trading under Fed Funds. The entire US Treasury curve is trading under Fed Funds, which is a pretty clear indication that Fed policy is too tight right now. Note the past few times that the UST curve was under Fed Funds we saw the Fed embark on significant rate cuts eventually. Obviously rates today aren't as high as they were then, but this argues to me that the Fed must cut rates further…and sooner rather than later.



On tap today we have US CPI. A soft reading there will only further strengthen my argument the Fed is too tight. Otherwise, I don't see much else on the calendar. I guess we'll keep an eye on developments in both Hong Kong and Argentina today.

Energy

Crude oil prices have been fairly steady over the past few days. The market seems to be playing a balancing act between some soft economic numbers but some concerns of potential tightening supplies. Interesting to see that one of the new Permian pipelines has started operations. Trafigura has started shipments of Permian crude oil to Corpus Christi via the new Catcus II pipeline system. Right now it is expected that the pipeline will run at a flow of about 300,000 bpd in Aug but it has full capacity up to 670,000 bpd and we could reach capacity by Sept. That will be an interesting shift for the region, which has seen West Texas prices trading at a discount to WTI for a while due to lack of pipeline capacity. It will be interesting to watch how this impacts WTI spreads and storage levels at Cushing. Thoughts appreciated.

Today's Calendar (all times Central)

- CPI – 7:30am

Thanks for reading.

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