

# THE WATERTROUGH

Cows in Control Newsletter

**February 2015**

## Trouble ahead in beef prices?

Well, I promised volatility this year. Though we have been immune to it in Canada for the most part, feeder prices are off nearly 20% in the US. We can thank our falling dollar in Canada for insulating us from that drop, but caution is in order.

### A reminder of our services:

Please feel free to contact me about the following services:

- 1) Developing an annual marketing strategy for your cattle
- 2) Working with you to protect the value of your herd
- 3) Options for retained ownership and forward selling
- 4) Assisting you with buying and selling
- 5) Keeping you up to date with market programs and trends

Give me a call for a free consultation

*"Markets move up and down on average around 20-22% in a year, the higher our prices get, the more that means on a price per pound basis"*

*- Ryan Copithorne*



Go ahead, step on that bronc! That's what ranching without price protection is like!

## In This Issue

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- Deflation
- Bred cow values next fall
- Hedging your calves
- What to do with your background cattle
- Thoughts on the industry





Charlie Russell - great isn't it?

## Deflation...

Global commodity deflation could be the biggest concern that is hitting the market now as a risk to our cattle prices. Look at the list of commodities and the deflation in prices they have undergone since their highs... [see chart below]

So far, feeder cattle prices have fallen 19% and fat cattle have fallen 8%.

Compare that to hogs on the other hand that have dropped 54% from their highs in July of last year.

Lets be thankful cattle prices have outperformed other commodities, but also cognizant that cattle are a commodity, and commodity price drops can fall much further than people think is rational sometimes, despite the fundamentals. When so many commodities have dropped, and cattle are the last holdout, it is a good idea to get hedged.

Deflation is a result of the US dollar rising (as commodities are priced in US dollars) as well as slowing demand due to global economic slow down.

## The Marketing Buzz (Feb 10)

Prices in Canada are cooling a bit but no where near what they are seeing in the US thanks to our weak dollar. Futures prices are setting back as interest is waning from speculators.

## Canner cows, heiferettes and bulls

Cull cows if you still own them are trading anywhere between \$1.05 - \$1.40/lb depending on quality in the ring. Open heiferettes are ranging either side of \$1.50/lb and bulls are around or under \$1.50/lb on average. These prices have held up quite beautifully despite the drop in meat prices in the US. These prices are truly the barometer of actual meat prices when the funny money in Chicago starts swinging the futures market.

As always, give me a call if you have cattle to sell as I can get direct and rail bids to compare against your local pricing.

## Feeders

Steers:	650 wts	\$2.73	Heifers:	650 wts	\$2.48
	750 wts	\$2.49		750 wts	\$2.33
	850 wts.	\$2.34		850 wts	\$2.21

## Finished Cattle

\$1.87 cash

Feeder Basis: -21      Finished cattle Basis: -13.5

	High Price (\$)	Date of High Price	Decline from High Price <sup>1</sup>
Natural Gas	13.7	June 28, 2008	80%
Cotton	227.0	March 7, 2011	74%
Oil (WTI)	147.3	July 11, 2008	66%
Iron Ore	183.5	February 15, 2011	63%
Wheat	1,334.5	February 27, 2008	63%
Rice	24.7	July 1, 2008	58%
Corn	799.9	June 10, 2011	54%
Coffee	308.9	May 3, 2011	47%
Copper	463.2	February 14, 2011	46%

*Average Decline of Sample Commodities*

**61%**

<sup>1</sup> As of February 1, 2015.

Table courtesy of Windrock Wealth Management





## What are bred cows going to be worth this fall?

First of all, the Canadian \$ will be the biggest variable. Despite this, in order to make an educated decision, we have to look at the cattle futures market.

A common historical assumption is that cow values will be 1.5 times the calf value (Ex: a \$1500 calf translates to \$2250/cow [1500 x 1.5]), therefore, if we can estimate from the futures what the calf price will be, we can get a closer estimate of what the cow price will be.

Using October feeder futures and a 20 under current basis, that puts us at \$3.03/lb for a 500 weight steer calf for next fall. That equates to about a \$2200-2300 bred cow price. But let me show you how those numbers can change with a change in either the dollar or the futures price...

[see chart at top right]

You can see that a modest 10% price movement in the dollar and the futures will range us in the \$1900-2700 range depending on the variables.

You can add or subtract another \$0.50/lb to calf prices in a 20% correction

For clients, we can easily hedge the dollar, and can hedge calf prices using either feeder futures, forward sales or WLPIP to protect your bred cow values into the fall in addition to your calf values.

## Calf price and Bred Cow Price Projections for October

Feeder Futures price	\$ 2.00 /lb for an 850 lb steer
Canadian Dollar	\$ 0.7919 CAD:USD
Basis	\$0.20 under
Slide 850-500 lbs	\$0.20 /cwt

Assumptions for next fall's calf pricing:	500 lb steer calf price	Bred Cow Value
At today's pricing:	\$3.03 /lb	\$2,269
If the dollar drops 10%	\$3.31 /lb	\$2,480
If the dollar rises 10%	\$2.80 /lb	\$2,097
If futures drop 10%	\$2.77 /lb	\$2,080
If futures rise 10%	\$3.28 /lb	\$2,459
If the dollar rises 10% and futures drop 10%	\$2.57 /lb	\$1,925
If the dollar drops 10% and futures rise 10%	\$3.59 /lb	\$2,690
Min	\$2.57 /lb	\$1,925
Max	\$3.59 /lb	\$2,690

The cattle bull market of the 1970's

## Hedging this fall's calf prices

**WLPIP:** The current WLPIP calf price insurance lets you lock in a 6 weight calf at \$2.56/lb for the cost of \$0.0772/lb. That equates to \$2.68/lb for a 500 weight calf after premiums are paid. That will cost around \$3860 to protect 100 calves. A simple 10% price move down below \$2.68/lb unprotected would cost you around \$13,400 to compare. Looking at the minimum and maximum figures for projections above, you can see that it is an Ok deal, not a great deal to hedge with insurance right now. You are still covered in the case of a severe downward market which is advisable, yet there is nearly a dollar of lost hedge potential in the more optimistic projections. What can we do with options?

**Options:** With a straight feeder future put option, you can lock in around \$2.89/lb Canadian for a 500 lb steer including hedge costs at today's prices compared to \$2.68/lb using WLPIP. The cost would be more like \$7000 but for the additional \$3200 over WLPIP premiums you are locking in \$10,500 more value. However, there is risk if the Canadian dollar moves upward, and basis risk to pay attention to using options.

Canadian \$ risk can be easily fixed for not much money, and basis risk is likely no more than \$0.15 of downside to match our worst levels last fall with the possibility of \$0.05/lb upside benefit if we return to a more traditional 15 under basis.



# What to do with your backgrounded steers?

For most ranchers, if you have kept your steer calves, you will likely have steers weighing in that 650-750 lb range on a common ranch backgrounding ration. The question is, what to do from here?

Your steers are likely worth \$2.50-\$2.70/lb right now to sell, or around \$1625-1875 per head.

Let's look at some options. Using the futures and today's basis, I will make some ballpark projections on what prices will be when you sell.

**Option 1:** background at 2 lbs/day until May

**Option 2:** background at 1.5 lbs/day until May and grass until October

**Option 3:** background at 2 lbs/day until 850 lbs and then finish the cattle

Let's use 700 lbs as our start weight at \$2.60/lb...

**Option 1: \$25 per head loss**

**Option 2: \$122 per head profit**

**Option 3: \$22 per head profit**

Note: none of these profits include the cost of hedging and are susceptible to price movements. All figures estimate shrink, freight, and selling expenses.

## Contact Us

Give us a call for more information about our services and products

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Cows in Control, serving the cow/calf producer

# Thoughts on the industry

North American grain finished beef is finally again gaining ground back from beef in primarily grass finished regions. North American beef averaged around \$3.30/lb (USD) last year compared to \$2-2.50 for beef from Australia, New Zealand, South America, etc. Over 17% of the beef prices in the US last year according to Cattle Fax can be accounted for by export values, and growing 6% a year. The world is starting to compensate for grain finished quality. I have not seen figures for Canada, but this demonstrates the tremendous value of beef exports either directly or as we market to the US.

The hamburger to chicken breast price ratio is now at a record high 2:1 and the cattle to hog price ratio is 2.57:1 showing the strong demand for beef, yet there has been essentially 8 years of no growth in beef production.

FAO/UN says we will need 9M tonnes more beef over the next 9 years to keep up with demand growth globally. My cowboy math puts that at around 40 million head of cattle equivalent we need to add to the planet. Either we step up and produce more product, or our beef will become too costly, as we are already 2-3 times over pork and poultry prices, and beef continues to lose market share. Job #1 is getting the next generation ranchers capitalized and enthused about our business.

There's conservation efforts out there from leopard frogs to old leotards but who is making sure the rancher survives this era of volatility, huge capital costs, over regulation, and the battle to hang on to property rights. Big challenges. Get the young people excited by the profits in our business, give them a stake, we need their energy for this next leap. — RC