

THE WATER TROUGH

Cows in Control Newsletter

October 2016

You want cattle prices to go up? Eat more bacon...

This has been a perfect storm of cheap grain and low interest rates causing excess meat production in pork, poultry and beef. While a massive pork supply is being worked through, beef struggles along side. The US is struggling to sell its production globally due to its high dollar, and has to eat its own supply. Lastly, we have the collapse in dairy prices flooding the meat market with dairy beef. Park the veggies, we need to eat more meat!

Cows in Control services:

- 1) Developing an annual marketing strategy for your cattle
- 2) Working with you to protect the value of your herd
- 3) Analysis on retained ownership and forward selling
- 4) Making sense of the markets

Give us a call for a free consultation

“The key to risk management is never putting yourself in a position where you cannot live to fight another day.”

*- Richard “Dick” Fuld
(former CEO of now defunct Lehman Brothers investment firm)*



Jumpin'pound Round Up Crew 1940's

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Oh the tension...

The Canadian dollar has been trending flat at around the 75-77 cent level since early in the spring.

As you can see from the chart of weekly Canadian dollar futures at left, we are still within a longer term down trend. This consolidation has been riding the upper resistance level of that down trend but has been unable as of yet to penetrate it.

It actually appears that the sideways consolidation is now due to break its own support line (the blue line on the graph) at around the 75 cent level which would take the Loonie down to the low 70 cent level and possibly below. This would be very bullish for our Canadian feeders!

The market is somewhat oversold and due for a bounce upward. We will see if it has strength to break through that upper resistance when it does.

If we look at oil futures (the biggest influencer on Canadian dollar prices) we see that it made a head and shoulders bottom, but was unable to follow through what we call the "neckline". It looks like oil

Sideways and then what?...

The Marketing Buzz (Oct 21)

Canner cows, heiferettes and bulls

Cull cows: \$70-95 Heiferettes: \$110-135

Cull Bulls: \$100-125

Breds Not enough volume to determine (indications \$1600-1900)

Feeders *(Write these light cattle prices on a wall to remember)*

Steers: 450 wts	\$1.83	Heifers: 450 wts	\$1.57
550 wts	\$1.68	550 wts	\$1.45
650 wts	\$1.63	650 wts	\$1.42
750 wts	\$1.58	750 wts	\$1.41
850 wts.	\$1.52	850 wts	\$1.40

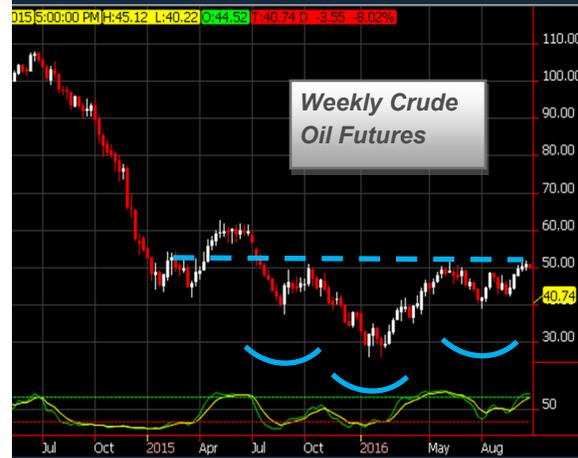
Slide 550-850: 5 cents!!! Heifer:steer @ 750 lbs: -17 cents

Finished Cattle

\$1.32 (now back to 2013 pricing)

**Feeder Basis: -10.9 Finished cattle Basis: -3.2 (futures)
-1.0 (Cash)**

(*Note: mid to upper weight feeders are priced at a premium, good time to unload your grass cattle and replace with light calves)



is going to fall once again into the 40's. This should bring the Loonie down with it if this is the case.

Fall grass once again



A look at 2016 hedging...

At right are various hedge profits you could expect on a year of steady dropping prices like we saw this year.

For this analysis, we assume you decided to lock in the seasonal highs for 600 lb steer calves in February for end of October delivery.

There was almost a dollar a pound lost since February on 600 lb steers which is a \$582/hd loss. Ouch!

What could we have done hedging to alleviate the pain of that loss?

From the comparison we see that no hedge would have fully covered the full risk of loss unless you were able to forward sell at February prices. (No feedlots were willing to forward buy in February so this was not an option unfortunately)

Besides simply shorting futures, buying WLPIP Calf Insurance ended up being the most profitable.

The difference between the \$582/hd loss in calf value and the hedge profits is explained by:

1. **Basis Risk:** basis went from zero in February to -10 today (Canadian:US prices)
2. **Slide Risk:** the slide went from 20 cents in February to only 5 today (6 weights cheap today)
3. **Canadian dollar appreciation**

A look at what a hedge would have looked like this year...



Price Drop Since February 2, 2016

February 2, 2016 600 lb steer price/lb: \$2.63/lb

October 21, 2016 600 lb steer price/lb: \$1.66/lb

Drop in Price since February: \$0.97/lb

Loss since February \$582/hd

Comparison of hedge methods

February 2, 2016 Strategy to hedge fall 600 lb calves

- Option 1: Buy WLPIP Calf Insurance
- Option 2: Buy WLPIP Feeder Insurance
- Option 3: Buy Feeder Put Option
- Option 4: Short Feeder future
- Option 5: Forward Sell (if possible)
- Long Canadian dollar

Hedge Profit per Calf

\$236
\$201
\$232
\$266
\$582
\$ 61

Management vs. Market...

You may have heard us say that one market move can negate a whole year's worth of management practices. We have quantified what the value per head of various management improvements are on your fall calves.

50 lbs more wean weight:	\$125
5% better wean ratio:	\$76
Low shrink on sale:	\$72
No commission sale:	\$20
Zero freight deal:	\$15
Reduced death loss by 1%:	\$10
Eligibility on a value added marketing program:	<u>\$83</u>

\$401/hd

If you do all of these management improvements it looks like about a \$400 per calf value add to your operations in this scenario.

In light of the fact that we have just seen over \$600 per calf lost since this time last year, you can see that price risk management trumps anything else you do in your operations.

We find it funny that price risk management is the biggest value add or saving in the ranching business, and yet only a very small percentage of ranch owners in the cow calf sector practice it!

Pricing calves is a year round activity, not a one time gamble in the fall.

Cows in Control, serving the cow/calf producer

Thoughts on the industry

This has truly been an unprecedented drop in cattle prices on a percentage basis. This drop is larger than any other drop in the past 50 years (or more?) which demonstrates the new era of volatility in pricing these days. It is not the same business it has been for many decades prior.

Couple ridiculously low interest rates with ethanol food for fuel policies and we get a perfect storm of rapidly inflating and then deflating prices. Ethanol subsidies supercharged demand for corn production, and farmers responded in full fashion. This collapsed the price of grains as literal mountains of corn and other grains piled up in response to the subsidy.

With ultra low borrowing rates and this abundant cheap grain, pork, poultry and feedlot operators were able to borrow crazy amounts of capital in order to turn cheap grain into rapid meat production. We are now at a point where if a pork plant goes down, they are going to have to euthanize hogs as capacity is not there to process the current supply.

In addition to this is the fact that processors are unable to run at full capacity due to labour shortages. Minimum wage increases, foreign worker restrictions, and the affluence in our society (no one wants to work in a plant anymore!) makes it tough for plants to stock up their labour supply and subsequent kill capacity.

Lastly, we have hormones, beta agonists, no restrictions on carcass sizes and general production efficiency increases allowing us to produce more meat than ever imagined possible. The grading system treats a Holstein steer that grades AAA or choice the same as a AAA or choice beef steer; madness. This is the battle that we have been fighting, I am hoping that we have seen the worst and that this growing global middle class can eat all this. I am betting this is so, let's hope.

— RC

Contact Us

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

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"TO LOVE THE LORD YOUR GOD AND TO SERVE HIM WITH ALL YOUR HEART AND WITH ALL YOUR SOUL – THEN I WILL SEND RAIN ON YOUR LAND IN ITS SEASON, BOTH AUTUMN AND SPRING RAINS, SO THAT YOU MAY GATHER IN YOUR GRAIN, NEW WINE AND OLIVE OIL. I WILL PROVIDE GRASS IN THE FIELDS FOR YOUR CATTLE, AND YOU WILL EAT AND BE SATISFIED." - DEUT. 11:13