Planning the Likely Future

By Wes Ishmael

Notwithstanding the collapse of cattle futures prices that ended last year and welcomed the next one in January, cattle prices remain in the historic stratosphere.

Historically scant beef cattle numbers continue to suggest fundamental underpinning for price strength to continue in relative terms.

"Preliminary forecasts indicate that year-on-year drops in U.S. cattle slaughter may essentially end by 2016," analysts with the Livestock Marketing Information Center (LMIC) explained in January. "By then, beef tonnage may post a small year-over-year increase….So the supply side suggests that beef and cattle prices will tend to gradually erode over the next few years rather than collapse, barring any outside market shocks like drought or a U.S. economic recession."

This would mean that national herd expansion is well underway. Until the USDA's annual cattle inventory report comes out Jan. 30, anecdotal evidence continued to suggest that expansion had begun; it's the degree in question.

"There is little doubt that beef cow herd expansion began in the U.S. in 2014," Derrell Peel, Extension livestock marketing specialist at Oklahoma State University, explained in his mid-December market comments. "Beef cow slaughter is down over 18%, and the nearly 8% year-to-date decrease in heifer slaughter is a strong indication of increased heifer retention. U.S. beef cow inventories will likely show a modest increase into 2015. However, cow and heifer numbers do not appear to be expanding in Canada and Mexico. North American beef cowherd inventories will remain tight for many months. Canada and Mexico have not yet started to feel the short-term cattle numbers squeeze that is associated with the early stages of herd expansion."

No matter how far along herd expansion, it will be a long and slow road.

"The path from herd expansion to higher beef production is a rather long one due to the production lags inherent in the system. This means for 2015 another year of smaller beef production," says John D. Anderson deputy chief economist at the American Farm Bureau Federation, in a January *In the Cattle Markets*.

In other words, planning amid historically high net revenue per cow, in tandem with historically high herd expansion costs makes the palms sweat even more than usual.

Define the Boundary

"Producers need to ask now where they want to be in three to five years. The answer to that question will reveal whether 2015 should be a year of liquidation, holding steady, or expanding the cow herd," Peel said in January.

For individual operations, Peel explained that taking advantage of the current market depends on several factors, including whether the operation has room to grow, market expectations for the next several years and whether the operator is planning to exit the business in the next few years.

"For some older producers, for whom retiring or exiting the business in the next few years is inevitable, the current market provides an opportunity to liquidate cattle assets at previously unheard of values," Peel explains. "Now is the time to develop a plan that might include, for example, liquidating older cows in 2015 and saving younger cows and heifers until 2016 or, perhaps phasing the final liquidation into 2017. The point is to determine where you want to be and when and start implementing the plan in 2015."

For producers forced to continue operating with reduced cow number due to drought, Peel emphasizes, "It is critical to manage forages for long-term productivity, and it takes management patience and discipline to maintain reduced stocking rates and allow forage recovery. Producers in this situation may be able to consider seasonal stocker enterprises to utilize limited available forage and generate some revenue while managing pastures for recovery…"

For operations running at full capacity, with no expansion intensions, Peel suggests the focus should be on maximizing productivity of current capacity.

"The market is rewarding calf production," Peel says. "Producers should consider any opportunities where spending a bit more on inputs might boost production or reduce the odds of death loss or lost productivity."

For producers already expanding their herds or contemplating it, Peel suggests pulling the trigger sooner may make more sense than waiting.

"Breeding female prices likely have not peaked and will, in any event remain strong in 2016 or beyond," Peel says. "Whether or not female prices are too high now is arguable but there is no doubt that at some point it will be too late to jump on the bandwagon. I expect that point is at least a year away and possibly two. Again, it is a question of how best to take advantage of current markets."

The Market Ahead

"Overall, with more meat in the pipeline and a tougher export market to deal with, it will be tough to replicate 2014's cattle market–especially the fourth quarter market, which was clearly one for the ages," Anderson says.

In simple terms, pork and poultry production are projected to be significantly larger this year. Less than expected production of these competing proteins helped support beef prices last year.

As for exports, the stronger U.S. dollar and trade barriers mean more of the increased pork and poultry production will have to be consumed domestically, adding further price pressure to beef.

"Demand has been very good, and we can hope–even expect–that it will remain so. But unless domestic demand actually improves, the balance of market fundamentals tilts toward some decline in prices from recent record levels," Anderson explains. "Keep in mind that year-over-year comparisons for the first quarter will still look quite good even if we aren't quite matching the fourth quarter records."

For price perspective, LMIC analysts note that fed cattle prices in 2014 (5-market negotiated) averaged just above $154.50/cwt., which was 23% more than the previous year. LMIC predicts fed cattle prices this year to be in the range of $162-$165/cwt., a 4%-7% in crease year-over-year.

"During the first half of 2015, prices are forecast to be above a year earlier, but that may change during the second half," LMIC analysts say. "By the fourth quarter, fed cattle prices could average a little below 2014's. Year-over-year increases in fed cattle prices may not occur in 2016."

According to LMIC, average prices for calves at auction last year was $246.44/cwt. It was $207.67 for yearlings. That represents a year-to-year increase of 43% and 38%, respectively.

"Calf and yearling prices in calendar year 2015 are expected to average above 2014's," LMIC analysts say. "Forecasts call for calves to increase about 13% and yearlings close to 10%. Those are much smaller percentage increases than recorded in 2014. As with fed cattle, calf and yearling prices are forecast to be a little below a year earlier by the fourth quarter of 2015. Looking ahead to 2016, calf and yearling prices will likely continue slipping."

It all goes back to expansion.

"Current cattle prices are a signal for herd expansion that will persist until enough expansion occurs to satisfy market needs," Peel explains. "Herd expansion is likely to take several years and strong cattle prices may be expected over most of that time."