



The Cycle Isn't Broken

Understanding the cattle price cycle will help beef producers prepare for market lows.

by Julie White

Preparing for market highs and lows will help the cow-calf producer remain profitable during the natural swings of the cattle price cycle, according to CattleFax Analyst Lance Zimmerman during the Trends+ cow-calf webinar hosted by CattleFax and Elanco. Understanding risk and making a plan are advantageous for a cattleman to have a sustainable business.

Market outlook

Since record-high levels in fall 2014, Mike Murphy, CattleFax analyst, said there has been a lot of pressure on the market but a lot of volatility influencing the market outside producers' control. Feedstuff market projections for the next six to 10 months will benefit the cow-calf producer.

"From a feedstuff perspective we'll certainly see favor to the cow-calf producer with cheaper feedstuffs in the short term, but more importantly not a lot of volatility going into next spring."

Murphy said. "Then we'll be looking toward the next crop as we evaluate the second half of next year."

Murphy explained that the corn supply is in a comfortable situation, and volatility will be limited, though there will be some swings in the market.

"For the 2015-16 marketing year, looking at the bottom line, supply or production side, this will be a sizable corn crop," Murphy said.

"From a supply standpoint we are comfortable. We don't really have an enormous demand base today out there in the market place for corn from the U.S. It's still very strong, but it's not what you define as a growing demand base. From a usage standpoint, we're talking about the same amount of corn used this year as we used the previous marketing year — 13.7 to 13.8 billion bushel of corn in terms of utilization."

On the forage side, Murphy expects alfalfa hay prices to remain strong. "What's keeping

that market supported is the drought on the west coast," he explains. "A lot of alfalfa is raised in that California, Oregon and Washington region."

Grass hay is experiencing some weakness, and it's expected to remain in that trend until next spring and summer. "There's plenty of hay being put up this summer as we had an exceptional spring and summer through the central plains region," Murphy said. "We expect more of that grass hay value decline."

Forecasting to the next year, Murphy said he expects a large increase in the beef cow number of 1.3 million head in 2016. "Beef cow slaughter has been running consistently 16-19% below year ago levels," he said. "The heifer retention that took place in the second half of 2014, those heifers are turning into cows and will be part of the cow inventory here on Jan. 1, 2016."

The expansion trend will continue into 2017-18, but the rate is unknown. "Mother nature will play a role as to what this inventory will look like further down the road," Murphy said. "A nearly two million head increase in two years is historically significant."

Roadmap for ranches

Zimmerman said the cattle and beef industry is coming off a market high and a period where the most equity is at risk. "We all recognize that the markets have an emotional component to them," he explained. "It's easy for us to recognize we hit a period of euphoria. Now we are going through this transition and could be in a stage of anxiety and we're eventually going to hit a depression. We're in equity preservation mode. When we get to cycle lows whether that's two or five years away, we can recognize those lows that present us opportunities so we can best maximize those opportunities."

Cattlemen should recognize that the risk is at a high right now, and they should stick to a plan or formulate one to navigate the upcoming market change. "We see that 550-lb. calf values have dropped \$42/cwt., that's \$230/head, from highs on average. Volatility remains extreme. The price change on week-to-week basis has been \$3.06/cwt. and up 8.5% in a 10-year average."

Cow-calf producers who have been benefitting from the market upswing are starting to lose leverage in the market place. "In exceptionally tight cattle supplies and exceptionally high demand, buyers weren't very discriminating in terms of quality, location or type of cattle," Zimmerman said. "But we're starting to see those price differences enter back into the market."

Zimmerman suggests considering the questions below to help cow-calf producers build business goals and better equip their operations for the natural cattle market cycle.

- 1) What do I consider a success in a given market year?
- 2) How much risk am I willing to accept?
- 3) Are the calves or feeder cattle I own hedged at a profit or loss?
- 4) Why did I execute that hedge strategy on those feeder cattle?
- 5) Can I build a hedging strategy in today's market environment to ensure a profit on my cattle?

Understanding the cattle price cycle is important, Zimmerman said. "The cycle is not broken. Profitability breeds optimism and fuels cow herd expansion. Prices are going to make corrections. What do we do now that we recognize that we are on the downward swing of the traditional cattle price cycle?"

Zimmerman said the cattle price cycle typically has four components. The "up cycle" is the high point and what was experienced at the end of 2014. Currently the cycle is in "transition years," and a "down cycle" is the bottom with lowest cattle prices with significant losses. Following the down cycle is another transition to the up cycle.

To enhance cow-calf margins, Zimmerman suggests cattlemen 1) reduce production cost, 2) increase the value of calves and cull cows, 3) develop or improve marketing and risk management plans, and 4) retain ownership through the stocker and/or feedlot segments.

"Get your operation in a position so that during the peaks you are building cash reserves," Zimmerman said. "You are selling more calves, selling more breeding females and putting the cash in the bank. When you get to periods when the cycle is reaching its troughs, that's when you build the operation. Look for ways to accumulate more pasture, cull deeper into the cow herd and work to retain more useful bred females and grow your herd base."

This advice is contradictory to what has been seen during this time in the cycle. "Everyone around you is focused on sitting back and building up the cow herd as prices are at their highest point at their peak and they are liquidating at the lows. It's not easy to execute, but producers who can position themselves to behave in this manner can find themselves more successful longer term and better positioned to weather the storms in the troughs of the cycles." **HW**