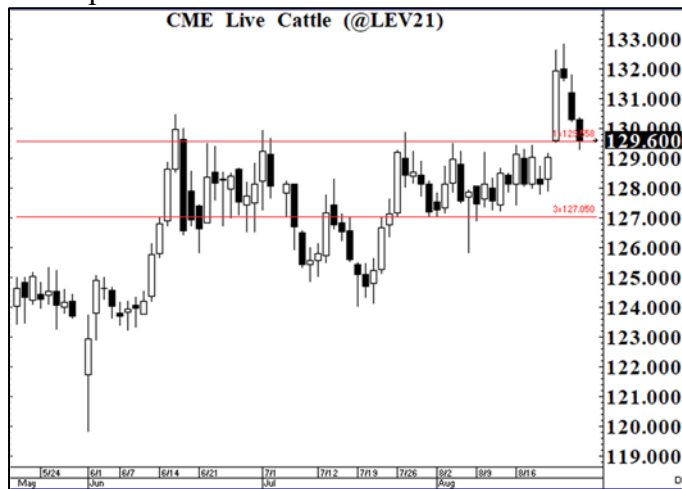


Well, I'm happy to report the wedding went wonderfully and it was truly everything I've ever dreamed of. I'm even happier to report, our wedding was not a super spreader – which is something brides worry about nowadays.

Cattle Overview

Until Monday, watching the Live Cattle futures market was like watching paint dry. The tedious grind sideways put even the most eager and caffeinated trader to sleep.



A similar bedtime story played out in the cash market. For eleven weeks, the 5 Area Steer Cash price traded between \$120/cwt and \$125/cwt (fig. 1).

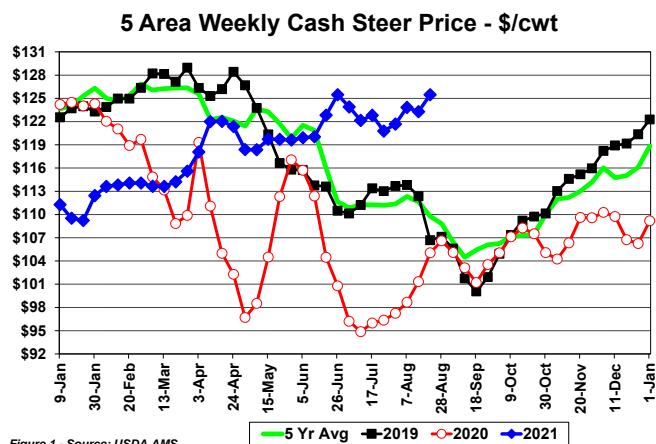


Figure 1 - Source: USDA AMS

Meanwhile, boxed beef prices made new 2021 highs (fig. 2). The enormous spread between cattle and beef prices remains an industry head scratcher. To be honest, it's difficult for me explain the disconnect in a

way than I haven't already done before.

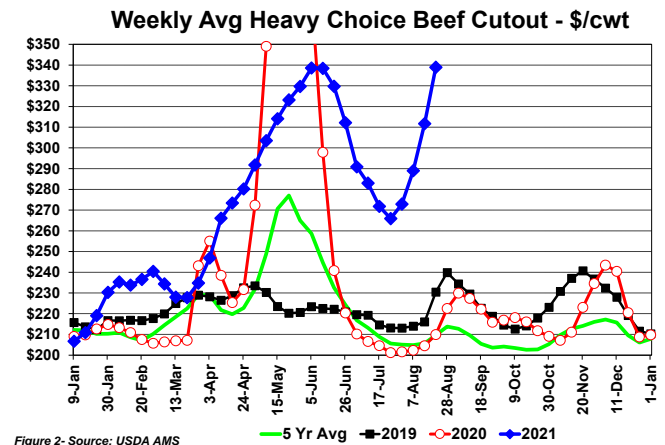


Figure 2- Source: USDA AMS

Labor shortages in meat processing plants and an overall surge in demand is driving the beef market. The two new strains of COVID-19 identified in the US produced headlines reminiscent of last year's lockdown threats. With the seed of disruption planted, panic buying plagued grocery stores. The annual average retail beef price is record high and doesn't show signs of cooling off yet (fig. 4).

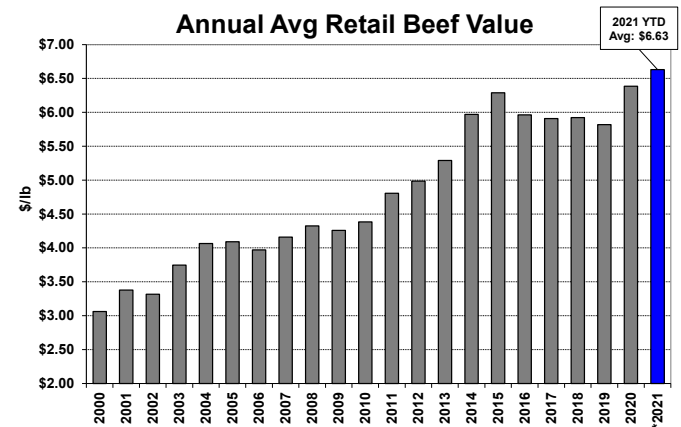


Figure 3 - Data Source: USDA ERS

The surge in beef prices understandably inflated gross packer margins. Year-to-date estimated gross packer margins average significantly higher than last year at nearly \$850/head (fig. 4). Remember in 2019, post-Tyson fire, when we thought one week at \$655/head was egregious. Wild stuff.

Year-to-Date Average Gross Beef Packer Margin - \$/Head

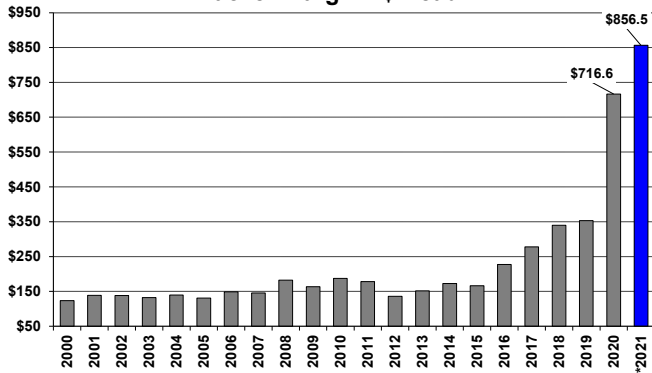


Figure 4 - Data Source: USDA AMS & NFC Markets

Beef prices aren't the only beef products cushioning packer margins: hide and offal values, a component of packer margins, are making new six-year highs (fig. 5).

Weekly Hide & Offal Value

Weekly Avg of Daily Values



Figure 5 - Source: USDA NASS & NFC Markets - Wkly 2008-Present

The hide and offal value includes the hide, head meat, organs, blood, intestine, and other variety meats. The variety meats, such as tripa, tripe, and oxtail are mostly exported to Asian countries and Mexico for consumption. The hides typically go to China for manufacturing. The recent surge in hide and offal values following the pandemic is due to both tight supply and pent-up demand.

Generally, when packers are short labor like they are now, they'll pull employees from the "gut floor" to the beef carcass fabrication floor. It's more important to the packer to have retail ready beef cuts available than it is to have cow tail ready for shipment to Asia. Therefore, not every animal's offal is being processed; maybe only 1 in every 4 animals' offal is fabricated with the remainder often being rendered. Rendering is a process that converts animal waste tissue into stable, usable material and essentially a way for packers to dispose of unused carcass parts. This leaves less offal products available to those who need it, like

Mexican restaurants. Speaking of tripe, does anyone know of a good place to try menudo? I'm uncultured in that area.

On the demand side, now that supply chains are reopened, the economy is coming back, and the demand for new cars is exceedingly high, as is need for leather. The problem, however, is what we discussed above: there is a shortage of available offal products due to labor issues. Long story short, the recent rally in hide and offal value is adding to profitable packer margins.

The bottom line is that the currently wide packer margin will eventually become unsustainable, as the slaughter-ready supply of cattle declines and slaughter capacity expands due to an increase in available labor. While this will be a very slow process and not something I feel is imminent, at some point leverage will gravitate towards the producer, which will be very friendly to live cattle prices.

According to the August cattle on feed report, on-feed inventories are down 2% from last year (fig. 6).

US Total Cattle on Feed - 1,000 Head

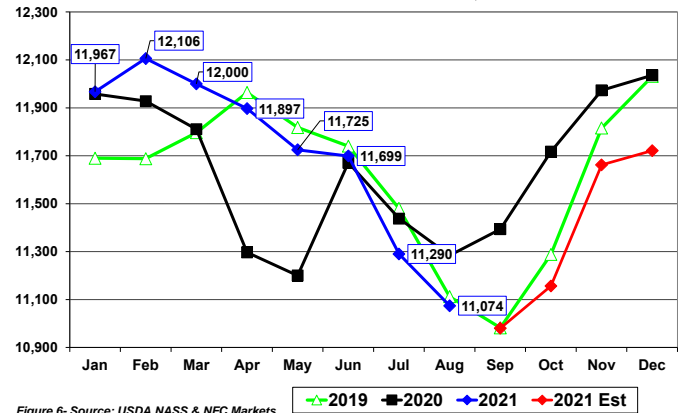


Figure 6 - Source: USDA NASS & NFC Markets

July placements were 8% lower than last year, marking the third month in a row of placements below last year (fig. 7).

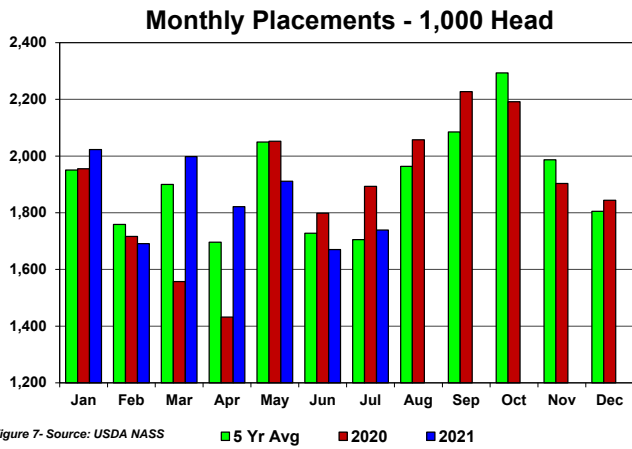


Figure 7 - Source: USDA NASS

■ 5 Yr Avg ■ 2020 ■ 2021

Marketings were 5% lower than 2020 due to one less slaughter day and continued packer labor issues. These estimates were slightly below pre-report expectations, igniting the price breakout on the following Monday.

Cattle Outlook

Unfortunately, the CME Live Cattle futures market's grandiose breakout was short-lived. After three days of corrective price action, the market is back to its familiar trading range. From a technical standpoint, it isn't unusual for the first breakout to correct lower and retest old highs. As long as prices remain above last week's lows, the breakout isn't deemed a complete failure.

From a longer-term fundamental standpoint, there is concern that the premiums carried by October and contract months beyond will incentivize producers to feed cattle to heavier weights despite the extremely high cost of gain. Near term, traders didn't like to see steady-to-lower cash trade in the south this week where the supply of slaughter-ready cattle remains large (fig. 8). As you can see in the following chart, I've compared current on-feed numbers to 2019 since the massive backlog of cattle created in 2020 makes a poor comparison.

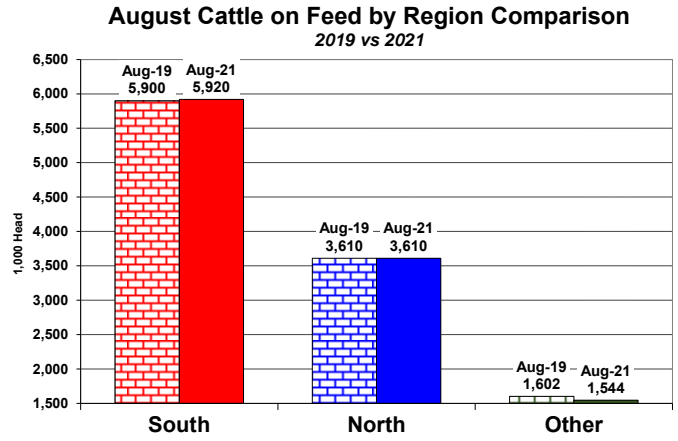


Figure 8 - Source: NASS

In addition, boxed beef values look like they're faltering. Even one of the most highly prized items, 50% beef trim, printed lower the past few days (fig. 9).

Beef Trim 50% Fresh, National (\$/cwt)

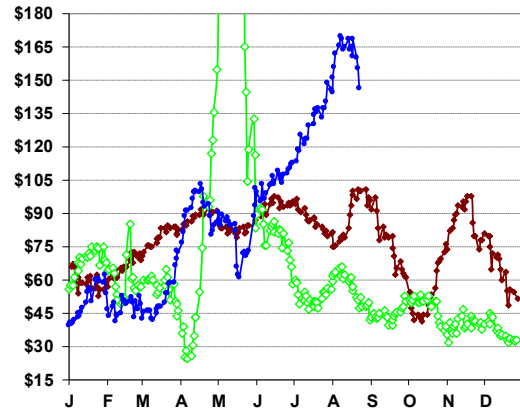


Figure 9 - Data Source: USDA AMS

Moving forward, cattle bulls need to limit downside follow through and solidify a possible breakout. Fundamentally, the packing industry needs to maintain kill pace and overcome labor challenges. For the time being, it's evident packers have control over the negotiated cattle market. After all, it appears cash prices are being held within a very narrow range, regardless of beef prices and slaughter-ready supply. Hopefully by early next year, leverage will shift in favor of the producer when available supplies tighten. DO NOT, however, hang your hat on that expectation. A lot of chips need to fall into place first.

I'll leave you with the same message from last month... While the futures market may be focused on the light at the end of the tunnel, you need to remain focused on your risk and exposure in the marketplace.

I'm headed to Kaua'i, Hawaii for a few days on our honeymoon. Vacationing on the beautiful US island requires top security clearance, your left kidney, and a

negative COVID test within 72 hours of departure. Wish us luck!



This **Monthly Cattle, Grain, and Cotton Newsletter** is written by Kristin Ritchie and reviewed by Daniel Bluntzer with New Frontier Capital Markets, LLC. New Frontier Capital Markets is a full-service agricultural-commodity brokerage specializing in risk management assessment, price analysis, and fundamental market research. **If you have any questions, please give me a call.**

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