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Hughes' Views

Revered livestock economist Harlan Hughes shares his five-year outlook for the beef industry.

*by **Kindra Gordon***

"There are opportunities for cow-calf producers to make some money in the beef business, especially in the next five years," believes Harlan Hughes, a well-known economist throughout the industry. Hughes, presently a consultant who also lectures across the United States and Canada on cow-calf business management, retired from North Dakota State University in 2000 and now lives near Laramie, Wyo.

Of his optimistic outlook, Hughes says historical Cattle-Fax data confirms that the industry is experiencing record-high prices. Furthermore, he reports that the data indicates most producers are participating in some level of those profits.

But what is going to happen next? And, if there is more money to be made, how can you get in on it? Here, Hughes shares his outlook and strategies for ranchers.

Heed the cattle cycle

Of utmost importance, Hughes says, is to recognize that the cattle cycle exists and is alive and well. "A lot of ranchers fight the cattle cycle," he says, "but if you do, it can eat you alive. Once you accept that the cattle cycle exists, you need to focus on what you can do to make it work for you."

Hughes explains that a typical 10-year cattle cycle has three phases: contraction, expansion and turnaround. In short, he says, "Cattlemen spend five years building their numbers and then five years taking their herd apart."

He reports that the beef industry has had a cycle like this every decade since 1930, with cattle inventory peaks — and price lows — tending to occur in the middle part of each decade. However, in 2005 the cycle is different due to the previous years of drought, he says. "We're having price peaks this time mid-decade."

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He explains that the current cycle is unique because of the effects of the drought across the western half of the United States in 2001 and 2002. Thus, Hughes says this cycle will probably be 13-14 years long, rather than 10. This is because instead of expanding cattle numbers when cattlemen would have typically done so three to four years ago, they had to sell off heifers due to the lack of grass.

With better precipitation early on in 2005, Hughes says the industry is going into the brief turnaround phase now and moving into an expansion mode. "We are seeing people start to hold back heifers," he says, and reports a 4% increase in replacement heifer inventories since January 2005. "We are rebuilding the U.S. cow herd, and it probably will occur for the next several years."

What to expect

So, now that the current cycle is changing, what does this mean for cow-calf producers? Hughes says there are several implications.

Foremost is that the holding back of heifers for breeding rather than feeding will mean fewer cattle on feed. He says cull cow numbers will also be down during the next few years due to expansion, resulting in fewer overall head in the feedlots.

These low numbers will have a significant effect on the feeding and packing industries, namely by preventing them from running at capacity. Hughes predicts some feedlots will be forced to close down until cattle numbers come back up. "Somebody is not going to have cattle to feed," he says. "Farmer-feeders will likely stop first. Big lots will close some of their smaller yards, and I'm already seeing some feeding more Holsteins just to keep their numbers up."

Similarly, with the low cattle inventories, packers are struggling to run at full capacity and have posted negative profit margins every month except one since January 2005, Hughes says.

As a result, he says, "The cow-calf man is in the driver's seat right now due to the shortage of feeder cattle." Hughes predicts record-high prices at the cow-calf level for about the next three years until cattle inventories are built back up.

Meanwhile, Hughes anticipates that heifer inventories will continue to increase for the next few years during the expansion phase. "The only thing that could change that is drought," he says. And, because of the strong price signals in 2003 and 2004, he also expects the cycle could grow slightly faster than it did in the 1990s. He predicts it will peak at about 103 million head of beef cows in the next five to seven years.

As those cattle numbers build, Hughes reiterates that cattlemen must keep the cattle cycle in mind. "Looking at the cattle cycle ahead of us, when cattle numbers go up, prices tend to go down, and vice versa. As simple as that is, it tends to be forgotten, and I'm especially seeing that now with the Canadian border issue."

But, no matter what happens at the border, Hughes says projections call for prices to drop off by the end of this decade. "Plan on prices coming down by 2008 to 2010," he advises. "Use these profitable times to build a financial reserve to help you through. And, if you believe in the cattle cycle, you know there will be another peak coming in the next decade; be patient."

What should you do?

Once you understand the trends of the cattle cycle — and where the industry is at in the current cycle, Hughes says you can start implementing several strategies to capitalize on those trends.

"Cattle cycles cause beef price cycles, and both are somewhat predictable," Hughes says. "So, you can come up with strategies to take advantage of it."

As an example, he advises that producers look at running their cow herd differently during each of the three phases (contraction, expansion and turnaround).

"What I'm seeing from the data I've studied is that no single production system works optimal throughout the whole beef price cycle. You may need to market your cattle differently up the cycle (in expansion years) than you do during a market that is trending downward," Hughes says. For instance, in some years selling at weaning may be most profitable; in other years holding calves longer or retaining all heifers may be a better strategy.

"I suggest that at the turnarounds you need to reconfirm your production systems, and realize production recommendations may have to change," Hughes adds.

He cautions that in turnaround years — like the present — it is risky to base decisions off of the previous year's prices. "In a contraction or expansion phase, you often can use last year's price signals, but it is easy to get frustrated in a turnaround phase, because things fluctuate quickly." Instead, Hughes advises looking at the present market situation for the year and making decisions independent of the previous year.

He also emphasizes that when prices start fluctuating, risk increases. Moreover, you can never predict when unforeseen events, such as terrorist attacks or a case of bovine spongiform encephalopathy (BSE), may occur. Hughes says cattlemen should first look at the opportunities to capitalize on good prices and build a financial reserve.

Hughes suggests that with the current record-high prices, 2005-2006 might be the ideal time to sell down.

"Bred cow prices follow calf prices, and my data show bred cow prices will peak in 2006," he says. "But, if you plan to liquidate cows, why wait? What if the prices don't peak or something happens? Perhaps a good strategy would be to sell some now in 2005 and the rest in 2006 to take advantage of the high prices."

Similarly with replacement heifers, Hughes says, "This is not the time to start a cow herd; wait three to four years. It's going to be a lot better starting a herd then."

"We see people trying to grow their herds right now with expensive heifer prices," Hughes says. "I'm concerned about that. My fear is that many ranches downsized their herd 25% to 40%, and now [they] are trying to expand. Because it is so expensive, I think we'll see ranches going out of business and up for sale in 2009-2012."

Hughes says the ideal situation is to build extra cows when the beef price cycle is down and then sell most of them when the beef price cycle peaks.

He admits this is tough to do if there is a drought, and this strategy requires that the cow herd size change with the cycles. Hughes says ranchers typically have a hard time accepting that, especially if they have the grass. "You don't have to use all your grass every year," he adds.

Hughes concludes, "When prices are high, sell everything you can. Get clean with the bank, then grow back up when prices are lower. The poorest choice right now is to buy back up to your stocking capacity at these prices."

Already looking to the next decade's cycle, Hughes shares a prediction: "In 2009, 2010 and 2011, you can hold back heifers for the next cycle, and then get in on selling the surpluses at the peak that should be building."

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What's driving current prices?

Economist Harlan Hughes says he commonly hears producers comment that the closed border to Canada is fueling the record-high beef prices in the United States, but Hughes disagrees. Rather, he says, the bulk of the record-high prices should be credited to consumer demand.

"New beef products, the Atkins diet's popularity and accelerated consumer spending on beef have been big pluses for our industry," he says.

The closed border to Canadian beef has had little effect on beef supply, he explains. "The U.S. has six to seven times as many cattle as Canada. For instance, Texas alone has more beef cows — 5.5 million — than Canada's total cow inventory, which is 4 million head."

For perspective, he adds, "Each year the U.S. holds back more replacement heifers than Canada has cows."

Hughes believes the bigger effect on beef prices will be the Japanese market. He says to keep prices up, those export markets need to be opened.