Profitability and Price Discovery Outlook

K-State economists share 2016 profitability predictions and price discovery information.

*Story & photos by **Kasey Brown,** senior associate editor*

Most attendees of an economic outlook presentation expect to hear about supply and demand. Those attending the annual Kansas State University (K-State) Cattlemen's Day in March were not disappointed. Glynn Tonsor, associate professor in the Department of Agricultural Economics at Kansas State University (K-State) is a staple to the program and presented the profitability outlook.


Glynn Tonsor

Supplies are historically tight, though herd expansion is well under way, Tonsor reported. Demand has been positive from 2010 to 2015, but concerns about its strength have grown since September 2015. Beef production is slated to increase through 2017 in both number of cattle processed and in pounds of dressed weight, he said, citing Livestock Marketing Information Center (LMIC) data.

Prices are projected to come down in 2016 and 2017, he said, noting $2 per pound calves in the third quarter of 2016 and down further in the fourth quarter of 2016.

Sharing data back to 1987, he said average annual returns of $150 for cow-calf producers generally are considered good. While prices are coming down from the record highs of 2014, 2016 is still projected to be well above the $150 mark. Average returns for 2016 are projected at $205, vs. $394 in September 2015.

"2016 is still projected to be a good year, just not as great as 2014 or 2015. This is still positive enough to keep expansion going, especially if it rains," Tonsor noted.

Addressing beef herd expansion, he added that 2015 showed a significant jump in heifers retained as replacements, and another 3.3% is projected for 2016. From 1970-2016, the average heifer retention rate is 17.2%; 2015 had a rate of 20.8%, and 2016 is projected to have 20.7%, which are the highest rates since 1969 by 26%.

Tonsor added that, historically, the cattle cycle takes about eight to 10 years. While this cattle cycle has not been typical, it is still a cycle. He estimates hitting the peak of expansion in about four years.

Beyond the ranch

He gave a brief outlook for stockers, advising stocker operators to do the homework before buying and selling calves. He gave two situations in which waiting to purchase and sell the calves actually offered higher expected values of gain.

Stockers are a margin business, and the market will give clues to those who do their homework, Tonsor said. He recommended the resource *www.beefbasis.com.*

For feedlots, he shared data that negative net returns were about to correct. Year-over-year demand for fresh beef has been up for five consecutive years. Per capita consumption in 2015 was up by 0.18%, and real all fresh beef prices were up by 7.66%. However, if real all fresh beef prices would have declined by 0.19% (which would translate to $5.60 per pound instead of $6.04 per pound), then that would have resulted in 0% demand change.

Tonsor's key point was the observation that a price and volume increase is a clear indication of demand growth.

Tonsor shared that total meat and poultry production is going up, and noted that exports are necessary to absorb additional production without substantial declines in domestic prices. The United States has yet to export 11% of its production for any given year.

"We need to make it a priority to break that 11% export 'barrier' because more domestic product at home drives prices down," he explained.

To summarize his profitability outlook for 2016, he predicted profitability for the cow-calf sector would be strong, but far from the historic highs of 2014 and 2015; stocker profitability would vary widely within the year; and feedlots would still have an ongoing struggle. However, he said, the worst may be behind us.

Price discovery

Fed-cattle price discovery has changed dramatically recently, which may change the way we do business transactions, noted Ted Schroeder, professor in Kansas State University's Department of Ag Economics and director of the Center for Risk Management Education and Research.

Schroeder gave the example of formula trading going up and negotiated price discovery declining from 2010 to 2016. He asked if this meant cattle were going the way of hog trading, in which about 3% of prices are negotiated, 50% are formula-based and the rest are contracted. However, he noted, cattle negotiated volumes have stabilized during the past year and are not spiraling down anymore.


Ted Schroeder

He cautioned against using the five-major-market average in mandatory price reporting because prices are divergent regionally. Since it's expensive to transport cattle to other regions, the report is often set by areas that are different than yours. There are likely other local supply and demand factors that affect the prices in your area.

Schroeder said the cash market and futures are invariably linked. He warned that anyone who hedged should watch basis.

This is a highly volatile market, he said, noting tight limits on cattle can exacerbate volatility. There is a much greater limit percentage in grain commodities.

There may be more changes coming, but some have already occurred, he noted, pointing out shortened trading hours, added messaging policy restrictions and allowed heifer delivery (1,050-1,350 pounds). Discussion of expanding trading price limits, delivery differentials, batch trades, holding trades for a second and instituting trading halts may change the way things are done.