Managing Risk During Expansion

CattleFax analyst offers risk-management tips to consider during expansion phase of the cattle cycle.

*Story & photo by **Troy Smith,** field editor*

The cattle cycle has not disappeared, nor is it broken. CattleFax market analyst Lance Zimmerman offered that reminder to cow-calf producers attending a risk-management workshop at the 2015 Angus Means Business National Convention & Trade Show. The workshop was part of a series of Angus University educational opportunities offered during the November convention in Overland Park, Kan.

Granted, drought and accompanying high feed prices confounded what most cow folk considered the "normal" cattle cycle. Liquidation of the U.S. cow herd brought numbers down to levels unseen for decades. Calf crops were smaller and demand for feeder cattle soared. Expansion was delayed, even when market conditions suggested the time was right. When moisture conditions improved, heifer retention began in earnest. It comes as no surprise.

"Profitability breeds optimism and fuels cow herd expansion (see Fig. 1)," nodded Zimmerman, calling it evidence that the cattle cycle is alive. "We've seen prices driven up for five years, and now we're in a transition phase, with prices shifting a bit lower through 2018. Then, prices will trend farther downward. A transition to stronger prices will come, but probably not until the next decade."

Zimmerman called feedlot profitability a fair indicator of calf demand, but he reminded the audience that cattle feeders had experienced losses for 12 consecutive months. With more females in production and more calves coming to market, buyers will be more discriminating.

Zimmerman said he expects plenty of market volatility — lots of ups and downs during the next couple of years. He looks for the price spread between northern and southern feeder cattle to widen. The spread between calves and heavier feeders should narrow.

"With expansion, feeder-cattle supplies

CattleFax Shares Market Outlook

Lance Zimmerman believes farmers and ranchers have a divine calling. He cites Psalm 104, Verse 14 as evidence. That's the one noting God's provision of the ways and means for men to "bring forth food from the earth." Of course, the Lord never said it would always be easy.

During an Angus University session of the Angus Means Business National Convention & Trade Show this past November, Zimmerman allowed that calf and feeder-cattle marketing in 2014 was about as easy as it gets. Cow-calf and stocker producers reaped a harvest of record-high prices. More recently, prices have been less favorable.

"The industry just came out of a perfect storm," said Zimmerman, explaining how prolonged drought in the central United States was a "market maker." Reduced supplies of grazed and harvested forages led to high hay prices and a dramatic reduction in national cow numbers. Corn prices were high, too, spurred not only by increased demand for livestock feed, but competition from the ethanol industry.

"It resulted in supply shock and demand shock for the cattle industry," Zimmerman added, noting how fewer cows, smaller calf crops and fewer cattle going on feed translated into smaller beef supplies. Meanwhile, U.S. beef exports remained relatively strong. Domestic demand held up far better than some pundits expected, despite soaring retail beef prices. Competitive protein prices were higher, too, as the pork and poultry industry wrestled with problems that whittled away their product supplies.

According to Zimmerman, all commodities were riding a wave of high prices. For the cattle industry, the wave broke during the latter part of 2015. It's disappointing for cow-calf producers, naturally, but not a disaster. The lion's share of calf sellers remained in a profitable position in 2015, just not as profitable as 2014. On average, said Zimmerman, calves would net about $350 per head in 2015, instead of $500 as in 2014.

Things are getting tight for stocker operators, and it's really tough for cattle feeders whose pens house high-dollar cattle, he said. Things won't improve anytime soon.

"In the near term, cattle feeders are the big losers, but most are trying to manage their risk," stated Zimmerman. "Beef packers are making money once again."

Zimmerman predicted the industry had seen the lower side of calf prices, at least for the next 12-18 months, and prices for 2015 would average somewhere around $250 per hundredweight (cwt.). However, he said he expected the average to pull back by about $40 per cwt. in 2016. The long-term trend is toward lower prices. The upper limits of fed-cattle prices are likely to be around $150 during the next 12-18 months. Some price volatility is expected at all levels.

Regarding heifer retention, Zimmerman said the industry appears to be on track for the largest year-over-year percentage increase in heifer numbers since 1959. The hold-back of heifers in 2015 is estimated at 1.3 million head and retention of another million breeding heifers is expected in 2016.

►"Profitability breeds optimism and fuels cow herd expansion," Lance Zimmerman said, calling it evidence that the cattle cycle is alive.

will grow to the point that cow-calf producers lose their leverage over other segments," said Zimmerman. "Those that expanded most in 2014 and 2015 will have the most equity at risk."

To manage risk during a coming period of leaner margins, Zimmerman advised cow-calf producers to seek ways to be low-cost producers, without sacrificing product quality. Producers should consider management practices that add value to calves and market (cull) cows (see Fig. 2). Zimmerman said producers should sharpen their marketing skills, remembering and taking advantage of market seasonality. Don't forget the cyclical nature of markets.

"At the peak of the price cycle, sell more heifer calves. At the cycle's trough, keep more heifers as replacements," counseled Zimmerman. "That's a basic strategy for navigating the cycle."

Zimmerman said it's not for everyone, but some producers may want to consider offsetting the risk of fluctuating cash markets by short hedging, using futures or options contracts. Retaining ownership of calves all the way to finish may be advantageous to some producers.

"Retained ownership is a challenge in a volatile market," admitted Zimmerman. "It still might make sense, especially if you can capture data and enhance your long-term marketing position."

Zimmerman gave two presentations as part of Angus University, the educational series sponsored by Merck Animal Health. To listen to his presentations and view the accompanying PowerPoints, visit the convention Newsroom at *http://angusjournal.com/NCnTS/2015/index.html.*

AJ

Fig. 1: The cattle price cycle

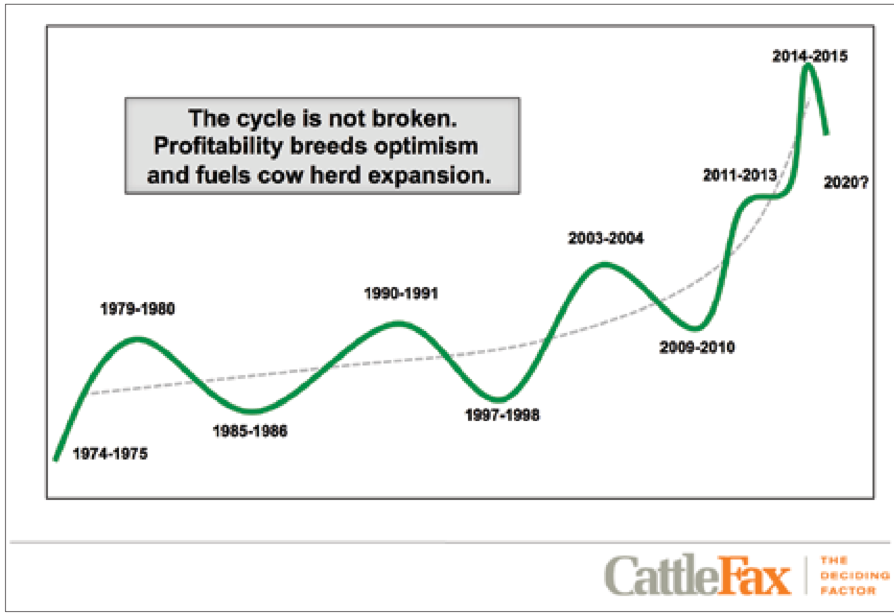
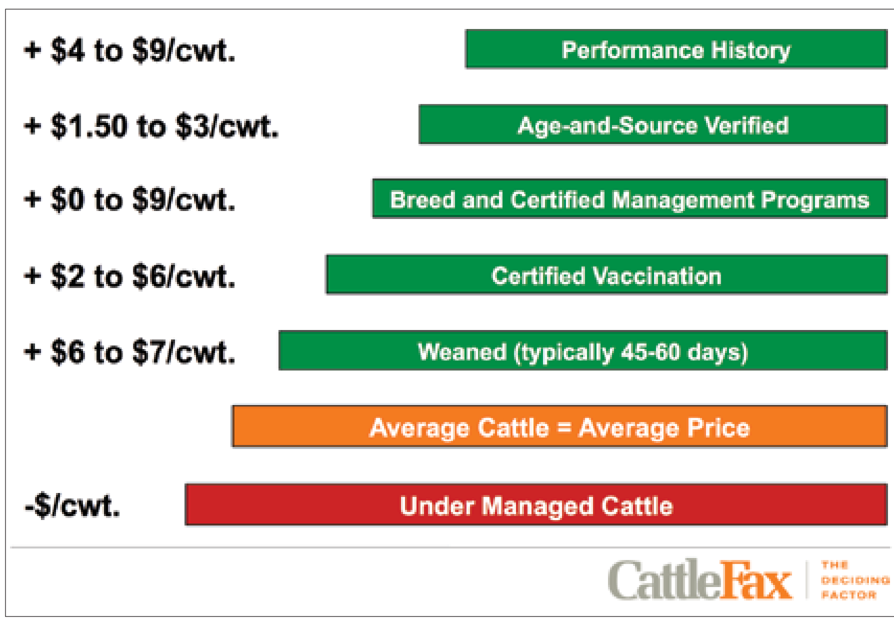


Fig. 2: Stair steps to profitability



Editor's Note: *Troy Smith is a freelancer and cattleman from Sargent, Neb. This article is part of the online coverage of the Angus Means Business National Convention & Trade Show provided by Angus Media. Visit the convention Newsroom available at* http://angusjournal.com/NCnTS/2015/index.html *to access additional summaries, PowerPoint presentations and the audio of the sessions.*

You can listen to Lance Zimmerman's presentation on risk management at *http://bit.ly/1RiRnM1.*