

9-18-1995

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Recommended Citation

Feuz, Dillon M. and Murra, Gene, "Developing a Market Plan For Calves; Changes in Hog Prices" (1995). *Economics Commentator*. Paper 323.
http://openprairie.sdstate.edu/econ_comm/323

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ECONOMICS COMMENTATOR

SOUTH DAKOTA STATE UNIVERSITY

No. 354 September 18, 1995



DEVELOPING A MARKET PLAN FOR CALVES

by

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The cattle market is currently in the downside of a price cycle. Depending upon which expert you listen to, prices may bottom this fall, in the fall of 1996, or perhaps in the fall of 1997. It may be difficult for many cow-calf producers to realize a profit by simply selling their calves in October or November. However, there will be opportunities to make money over the next few years. To do so will require a wise use of resources and a detailed marketing plan. The following nine-step approach may help you in developing your own marketing plan.

1. Identify your Resources

Each operation is unique. No single calf marketing plan will be profitable for all producers. Evaluate your land, pasture and crop resources and determine if you are fully utilizing them. Do you know the genetic potential of your cattle, in terms of average daily gain in a feedlot and ability to reach the USDA Choice carcass grade and carcass yield potential? Previous research has shown that these factors are critical to a profitable retained ownership program, particularly if you are retaining ownership until slaughter. You should evaluate your labor situation before retaining on your own operation. If you do not sell your calves at weaning, additional capital or financing may be
(Continued on next page)



CHANGES IN HOG PRICES

by

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Someone once said that the "only sure thing is change". That applies to most things in South Dakota, especially to weather and prices for agricultural commodities. Is there any predictability in that change? In some cases, the answer is yes. Specifically, the answer often is yes to the hog producer.

When the average monthly price for slaughter hogs in South Dakota for the last ten years is used, some fairly constant changes are noted. Further explanation follows.

In terms of price increases, average monthly prices most often increase between April and May (in the past 10 years, up 8 times and no change 2 times). Other upward moves were noted between January and February (up 7 times, down once, and no changes twice) and between May and June (up 6 times, down once, and no change 3 times). The largest month to month price increase was between November and December, 1990, when an \$11.10/cwt increase was noted.

There are several times when price decreases can be expected. Most noteworthy are between August and September (down 9 times and no change once), between October and November (down 9 times and up once), and between February
(Continued on p.3)

required to retain your calves. Carefully evaluate your management skills. Some producers have the management ability to utilize complex futures and options strategies, while others would not be comfortable using these tools.

2. Evaluate Alternative Strategies

Routinely selling calves on the same day every fall may not be the best strategy. With your resources in mind, consider all of your alternatives. If you have light calves, they may be successful in a drylot winter program and summer yearling program. However, heavier calves are not that well suited for this type of program. Do you have the feed and facilities to background or finish calves? If not, retaining ownership in a custom lot is an alternative. How long you want to keep your calves -- until after the first of the year, until spring, until slaughter -- should depend in part on what you expect the market to do.

3. Calculate Expected Break-even Selling Prices

For each strategy you want to seriously consider, you need to calculate an expected break-even selling price. This is a rather straight-forward procedure, but a very important step. Begin with the initial value of the calf at weaning and then add all costs involved in the feeding program (feed, supplies, labor, veterinary, death loss, etc). This total cost is then divided by the expected weight of the animal at the end of the feeding program.

$$\text{Break-even Price} = \frac{\text{Initial Value} + \text{Feeding Program Costs}}{\text{Ending Weight}}$$

If you know your total cost/lb. of gain -- from past experience or from a custom feedlot -- another method for calculating break-even selling price is as follows:

$$\text{Break-even Price} = \frac{\text{Initial Value} + (\text{TCOG} * \text{Gain})}{\text{Ending Weight}}$$

where TCOG is the total cost/lb. of gain.

4. Project Expected Market Price

Once you have determined your break-even price for a particular strategy, you need to project the market price for that weight of cattle and for the appropriate time period. None of us is a perfect

forecaster of prices. However, often it is possible to establish a range of expected prices. Determine the most likely price, the "Best Case Scenario" price and the "Worst Case Scenario" price. Compare these price forecasts to your expected break-even price.

By repeating steps 3 and 4 for several strategies, you should be able to arrive at the strategy that, for your operation, gives you the best chance at earning a profit.

5. Select the Feeding Location

If you choose to retain your calves, rather than sell them in the fall, then you need to choose the best location at which to retain them. For some strategies this may be on your own operation, and for other strategies this may be at a custom feedlot. When you are considering location there are a number of factors to evaluate, e.g., transportation to the feeding location and transportation to the market when the feeding period is over; climate differences; facilities and management ability; market access. Market access may be very critical. Studies have shown that selling price is the most important factor affecting profit in a feeding program. Feedlots that are closer to major feeding areas will likely have more buyers at their lots and can probably help you get a higher selling price.

6. Obtain Adequate Financing

Retaining ownership of calves beyond weaning requires additional financing for most producers. The calves will not be sold in the fall, so operating notes may have to be carried through the feeding period. Additional finance may be needed to cover the feeding costs. Some custom lots will carry this cost, and others will not. Determine the interest rate and other charges a feedlot may have and compare those to what you could get from your lending institution. You also may want to consider financing for a hedging account. Make sure your banker understands your hedging program and the need for possible margin money.

7. Contact a Commodity Broker

If you are planning to use futures and

options then you must have a broker. Even if you don't think you will use these market tools, it probably is a good idea to have a broker you can talk to. They may be able to give you valuable market information and perhaps help you avoid large losses from unfavorable market prices. Choose a broker who is knowledgeable about cattle. A broker who loves to trade wheat will be able to execute your cattle market orders, but may not have any sound advice for you. Make sure your broker understands your goals and market plan and is available to talk to you. Lastly, become knowledgeable yourself on the futures and options markets. Even if you don't actually trade futures, understanding this market can help you in your cash marketing.

8. Develop Marketing Plan

You need to have some specific goals for your marketing plan. Some examples may be to hedge if you can lock-in \$20/head profit, to limit risk by selling in more than one market at different times, or to hedge 1/2 of your cattle at placement. Your plan should address when and how you plan to price your cattle (cash market vs. futures market, live vs. dressed weight, prior to vs. at delivery). Also consider when and where you plan to deliver the cattle. Consider seasonal price patterns and differences in regional cattle prices. Finally, **WRITE YOUR PLAN DOWN**. Review it with your spouse and others, and then **EXECUTE IT**.

9. Evaluate Success of Strategy

When the strategy is completed and you have sold the cattle, evaluate how well you did. Did you correctly estimate your feeding costs? How well did you predict the market? How did your hedging program work? Answers to these questions should help you in putting together next year's plan.

There will be opportunities for profit during the next few years. Only those who know their resources, evaluate feeding alternatives, and have a well developed marketing plan will likely earn those profits.

(Changes ... cont'd from p.1)

and March (down 8 times and up only twice). The largest month-to-month decrease was \$7.50 between October and November, 1987.

The lowest average monthly price during the year for each of the last 10 years occurred twice in January, twice in April, once in September, 4 times in November, and once in December. In general, lows occur more often early and late in the year.

The highest average monthly price during the year for each of the last 10 years occurred three times in February and May, twice in June, and once in July, August, and December. In general, highs most often occur during the late Spring and Summer.

The worst year (in terms of price decreases) probably was 1987. The average price for August of that year was \$59.00. Prices declined by \$4.50 from August to September, by another \$5.80 from September to October, and \$8.50 from October to November. The average price for November was only \$40.20, or an \$18.80 decrease from the August average.

The best year (in terms of price increases) probably was 1986. The average price in April of that year was only \$39.40. Increases of \$4.90, \$7.40, \$6.80, and \$3.10 were noted between April and May, May and June, June and July, and July and August, respectively. By August, the average price was \$61.60.

It probably is not surprising to hog producers that 1994 was a "bad price year". The yearly average price of only \$40.80 was the lowest of the past 10 years. The average monthly prices for October (\$32.80), November (\$29.00), and December (\$31.40) not only were the lowest of the 120 monthly average prices for the last 10 years, they were the only monthly average prices below \$35.00.

In general, 1995 prices have been above 1994 prices, sometimes by as much as \$10.00. If historical patterns are followed, prices probably will go down from mid-September levels in the upper \$40's. Average monthly prices from September to

November have increased only 4 times, have decreased 15 times, and stayed about steady only once in the last 10 years.

What does the above mean about the rest of 1995? First, it would seem that prices in October should be lower than prices in September and that November prices should be even lower than October prices. That conclusion is in line both with history and with current price projections.

Second, it is extremely unlikely that the large price reductions noted in 1987 (down \$18.80 from August to November and down \$14.30 from September to November) will be repeated. However, current prices (mid-September) in the upper \$40's could be replaced in October and November by prices in the lower \$40's. Last year's under-\$30 level seems completely out-of-reach. Below \$40 is not.

The Hog and Pig report will be released on September 30th. Look at that report for signs of liquidation. Currently, there is disagreement on

what is happening. If the report has indicators that liquidation has and is occurring, prices above \$40 for the rest of 1995 and even into 1996 could be the rule rather than the exception. However, if liquidation is not indicated, then the \$30's could appear at least part of the time during the next year or so.

Current high grain (corn) prices discourage expansion and encourage liquidation. Current high cash hog prices encourage expansion and discourage liquidation. Time will tell which is the more powerful force.

ECONOMICS COMMENTATOR

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