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CATTLE FUTURES: An investor's dream

April 26, 1972

INTRODUCTION

This brief report attempts to present a less-than conventional view of the 1972 Beef situation by accepting the logic of political gamesmanship in the direction of the U. S. Economy. Our thesis is fraught with danger for it may be labelled naive and cynical and because it runs counter to conventional wisdom. It is, nevertheless, supported by powerful technical trends which leave little doubt as to the outcome of the controversy.

WHAT'S BEHIND THE BEEF CATTLE BOOM ?

For one thing, the South West had one of the worst droughts in history last year and this helped to create the first cattle shortage in a decade. There was not enough pasture to support brood cows and thousands were sold for slaughter, resulting in diminished supply conditions throughout 1971. More importantly, beef demand continues to grow and with the economic recovery begun in late 1970 this growth has accelerated. Per capita consumption in the U. S. as increased from 64 lb of beef per capita in 1947 - 1949 to 105 lbs by 1967 and to slightly over 114 lbs in 1971. Per capita consumption is highly correlated with disposable income which according to most forecasts is due to rise by over 6 % this year.

WHAT IS THE SUPPLY SIDE OF THE EQUATION ?

The 23 State Cattle and calves on feed report indicated that placements during the quarter were only 2 % more than a year ago, well under the expected 6.5 % figure. Marketings were 3 % higher and in line with expectation while the number on feed at 109 % was slightly less than had been generally anticipated.

The relatively low placements was a surprise in view of the high cattle prices and low feed costs. Producers have been withholding cattle from the market with the intention of breeding and building up a large stock. Feeders, in turn, take their time in fattening their steers before selling them. Sometime in the future expanded slaughter supplies (in the form of increased and weightier animals) will hit the market and get the cycle once again to run from low prices to contracted output. Trying to guess the peak of the cycle, though, when consumer demand remains high and rising and inflation rampant, is a futile and dangerous exercise.

1948 / 1972: TWO U. S. ELECTION YEARS.

Much has been said in the past 6 weeks about rising food prices, particularly meat. The blame has been laid squarely on the shoulder of the middlemen. Indeed, a suggestion that the farmer was to blame, partly or entirely, was brushed aside by Agriculture Secretary Earl Butz when he argued that America's increasing appetite for meat and meat products usually involving a great deal of preparation and thus, costs, have kicked up prices.

Since the controversy started, various articles published in the Wall Street Journal, New York Times and other popular magazines have indicated (a) the difficulty in finding this 'elusive' middlemen and (b) the uniform attempt to protect profit margins throughout the production-processing-distribution channel. The words and actions of key men in Nixon administration (Butz's speeches to farmers promising them higher prices and Connally's jawboning of retail outlets) indicate that the administration is desperately trying to maintain simultaneously high farm prices and 'low' (or at least not high enough to evoke public outcry) retail prices.

Nixon is not a politician to ignore history; one of the greatest political upsets in American politics was the defeat of Republican Dewey to Democrat Truman in 1948. The reason: the traditionally Republican 'farm vote' went Democratic as a result of the farmer's dissatisfaction with the G. O. P. party.

States such as Iowa, Kansas, Dakota and Nebraska are highly important to the Nixon political strategy. These are cattle feeding states. Texas, which became last year the nation's No. 1 cattle feeding state, went to Humphrey in 1968 by a very narrow margin. Would happy farmers change their 1972 votes ?

In our view, and this is our basic assumption, Nixon cannot impose prices controls on farm products such as meat without running the real risk of losing the 1972 election. More so, he will adopt policy of 'benign neglect' towards the farm community.

THE HEAT IS OFF - AT LEAST FOR THE MOMENT

The labor Department reported on April 24th that the Consumer Price Index had showed no change in March (It was the first time since November 1966 that the index didn't rise.) The sharp improvement from the February consumer price picture was due almost entirely to a lower rate of increase in food prices, the most volatile component of the index. Food prices rose at an adjusted annual rate of only 2.4% in March after having soared at a 20.4% pace the month before. Prices of beef and veal rose in March, but at a slower rate than in previous months, while prices of fresh vegetables which aren't controlled dropped sharply.

The easier trend in wholesale beef prices since early February and some gentle jawboning on the part of Secretary Treasurer Connally have helped to bring about this price declaration.

In the first week of February, choice slaughter steers in Omaha sold as high as \$37.35 a hundredweight, a level not seen since March 1952. Since then cash prices have weakened to as low as \$33.50- 33.75 before staging a modest recovery to the present level of \$34.50. Should prices recover to the highs reached in early February over the next two months- as we contend- the following factors will militate against renewed public outcry:

- (a) It is a level already seen earlier and, as such, psychologically it does not evoke such violent reactions.

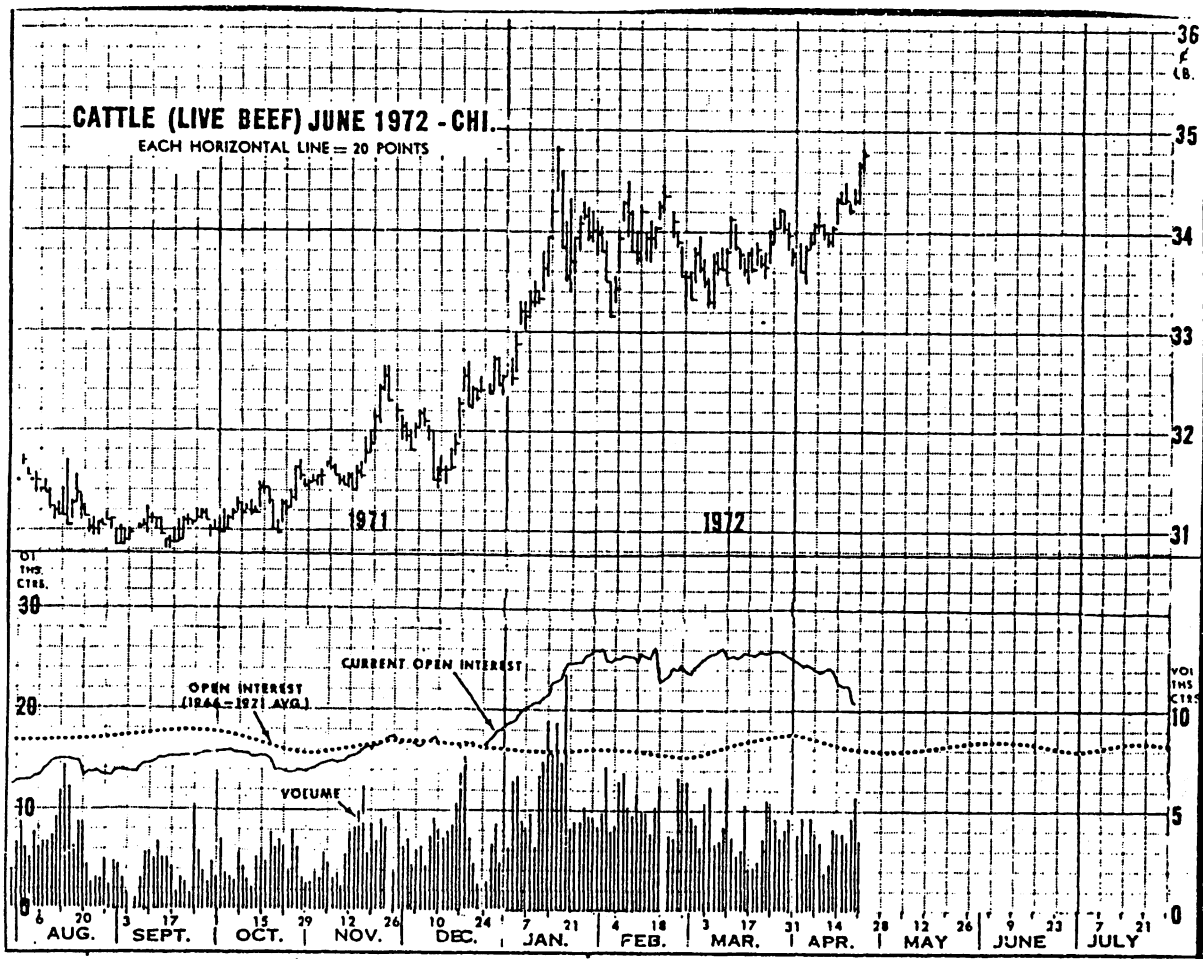
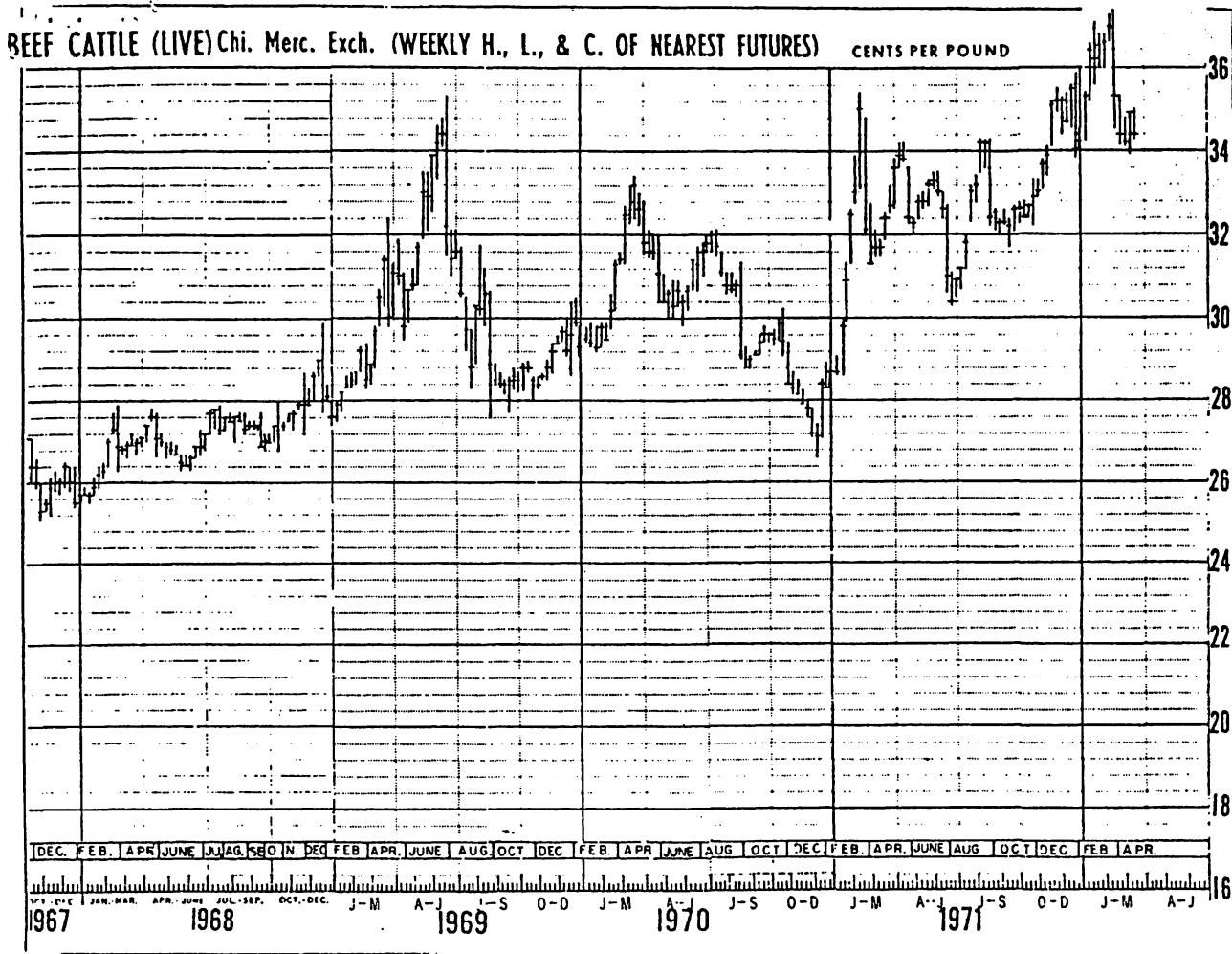
- (b) It can be better supported in the light of a higher general price level. Indeed, from early February '72 to mid June '72, the general price level will have advanced approximately 1 %, at best, but most probably 2 % .
- (c) It will not reflect itself fully, in the consumer price level until, probably July. Statistic showing the progress of the Consumer Price Index during July will not be public knowledge until sometimes the end of August, which will, in turn, be only 2 months before election.

We conclude that higher choice steers prices for the next 2 months should not be a cause of great concern to the Nixon Administration until sometime at the end of August. By then, the farm vote will have been cemented and the consumer will have to console himself with official pronouncements claiming that "as a result of recently established measures, meat prices will recede substantially from present levels in the next few months." Yes, after November 30th.

So much for political interference in the path of supply and demand.

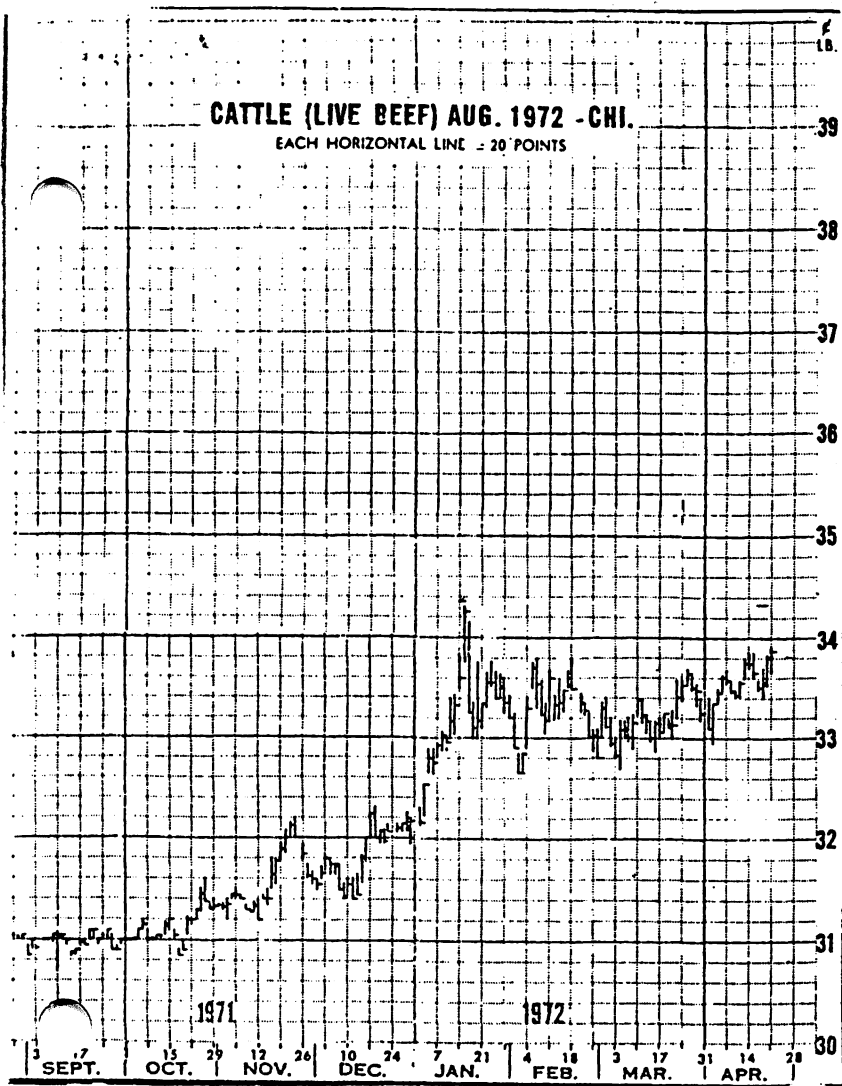
THE TIMING OF THE ADVANCE IN CATTLE PRICES.

- POLITICAL :** Anytime between now and November 1972, the closer to the latter date, the better.
- MARKETINGS :** Marketings follow very asymmetrical patterns. To the extent that cattle feeders tend to avoid scheduling marketings during periods when year earlier prices were low, prices tend to be strenghtened. Historical evidence bears this out: late winter and early spring was the period of lowest prices in 1965..... of highest prices in 1966.....and of lowest prices in 1967. The lowest prices in 1971 were recorded in late June and early July (\$30.50 - \$30.80 cwt from a \$35.60 - 30.50 range) and thus imply low marketings this June & July and thus higher prices.
- SEASONAL :** There is a tendency for prices to advance seasonally during the late summer, since this is the period when vacations and outdoor cooking boosts the demand for choice steer beef.
- TECHNICAL :** A thirteen-week high level consolidation bounded by the January high of 34.85 and the February lows of 33.17 (all basis June '72) was finally broken , when June moved to a high of 34.97 and closed at 34.85 (April 25, 1972). The long term chart of nearest futures indicate that the powerful uptrend begin in mid - 1971 will remain intact so long as the nearest contract trades above 35.80 - 36.00 past the middle of June. Since the August contract takes over the role of nearest contract after mid-June, and in view of the fact that August '72 sells at a 95 point discount from June, for August to be 35.80 -36.00, June will have to end at approximately 36.70- 36.90. This implies a 200 point advance from present levels and starting fairly soon.
(See nearest contract chart)
- RECOMMENDATION:** Buy June '72 and/or August '72 Cattle futures for a \$2-\$3 per cwt gain over the next two months. This would represent a profit of \$800 - \$1,200 per contract. Protective stops should be placed at 34.50 basis June and 33.60 basis August.



CATTLE (LIVE BEEF) AUG. 1972 - CHI.

EACH HORIZONTAL LINE = 20 POINTS



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CONTRACT FACTORS

EXCHANGE : Chicago Mercantile Exchange
HOURS OF TRADING : 10.05 A.M. to 1.40 P. M.
DELIVERY MONTHS : February, April, June, August, October and December
CONTRACT SIZE : 40,000 lbs of choice Grade Live Steers
COMMISSIONS : \$ 40.00 Round turn
MARGIN ON TRADES: \$ 500.00 U.S.

All statements made herein, while not guaranteed, are based on information considered reliable and are believed by us to be accurate.