

In a consolidated industry, the large packers are not price takers and we are seeing that fact demonstrated again. Facing negative margins periodically for weeks, packers started reducing levels of operation and the result was lower cattle prices late last week. Boxed beef values had been above \$140 for some Choice categories but were sharply lower on Friday and that trend will continue this week. Monday's numbers were sharply lower. Demand is not the problem. I just updated the demand index (www.aaec.vt.edu/rilp) for the third quarter and the year to year increase compared to quarter 3 of last year is one of the largest we have seen since demand finally stopped declining in 1998. Per capita offerings for the quarter were 17.0 lbs, up slightly from last year's 16.9 lbs but price was up nearly 10 percent after adjusting for price inflation. Combined, those positive measures show demand up some 9.4 percent as the index with 1998 = 100 jumped from 116.5 in quarter 3 of 2003 to 127.4 this year. In spite of this strong performance on the demand side, the cattle market is likely to drift lower in the short term in the presence of packer efforts to restore positive margins and the continued uncertainty about the opening of the Japanese market to U. S. beef. Weighted average lean hog prices in the cash market are sustaining price just under \$70 with little signs of seasonal weakness. I see support from continued robust exports to Japan as a major factor here. When last week's announcements indicated we may be months away from restoring shipments of beef, the lean hog futures closed sharply higher and they are up sharply again in early week trade.

I have been counseling short positions in the cattle complex, especially in feeder cattle. I did not think we could hold a high \$80's fed market with Japan still closed and have been worried about the impact of losses on cattle coming out of the feedlots between now and early 2005. Hold short positions in live cattle and feeder cattle futures until we see things starting to improve after the sharp losses that came late last week. I have been aggressive in feeder cattle and hindsight says I should have been more aggressive in suggesting short hedges in the live cattle futures as well.

December lean hogs may be headed for a retest of the September 24 contract high at \$71.80. The announcements that are suggesting no near term revival of beef shipments to Japan are very positive for hogs. I would be a short hedger or replace short hedges for hogs out through the first quarter of 2005 when that December contract approaches the \$71.80 high. Expect aggressive selling on such a rally and I would place the short hedges in the December at about \$71.65 to increase the chances of getting a fill on a good 'til cancelled order. Look at selling the February and April futures at that same time.

In the grains and oilseeds, there were competing forces in last week's markets. The U. S. dollar hit the lowest levels we have seen since 1995 and this makes our grains cheap in the world market and encourages export activity. Against that positive development is the imminent crunch in storage capacity as producers will be forced to sell corn into immediate transport channels, barge traffic in particular, because there is no storage to hold this huge 11.6 billion bushel corn crop. Local basis levels should weaken as the storage problem intensifies. Cash bids of \$1.60 or less are widespread in the Midwest, especially in states like Minnesota, and that means basis levels against the December futures of -\$0.40 or worse. Unfortunately, even if weak harvest period basis levels

suggest that hedged storage in the March or May futures should work this year, there may be no place to store the corn.

I expect December corn to challenge its October 12 low at \$1.97. The acid test in terms of inability to store this huge crop will start to emerge this week as the harvest moves toward completion. Let's wait and see if the \$1.97 level holds. Lift short hedges as the crop is harvested and look at the basis levels if you have storage capacity to see if hedged storage makes sense. Users of corn are clearly in the driver's seat here and there is no reason for anxiety. Pick the level that you can live with and if December at \$1.97 or so is too good to pass up, place long hedges out through 2005. We will see more uses becoming important this year as corn for ethanol will help ease the pressure, and I do not expect to see a repeat of the average cash price for the year as low as the \$1.50 that has come with record crops in the past.

November soybean futures will challenge the \$5.00 level and may slide below that level after taking out the October 12 contract low at \$5.06. Cash prices are down toward \$4.00 in many production areas and weak basis levels are prevalent in this market just as they are in corn. Use about the same strategy here as in corn. Let's monitor and lift short hedges as the harvest is finished. Uses of soybeans and soybean meal should not pass the chance to peg costs near historic lows in this complex. It would be hard to be wrong longer term if you place long hedges through 2005 when the November futures are below \$5.00 per bushel.

The wheat markets will be helped more than corn or soybeans by the low levels of the U.S. dollar, but this market cannot sustain a rally because the corn and soybeans continue to provide spillover pressure. The December Chicago and Kansas City contracts have tried to put in a bottom on several occasions and then the corn and soybean prices falter again. This week, it looks like the December Chicago wheat may be forced to dip to the \$2.97 low on October 12 before it can uncover buying support and we have the possibility of a double bottom at that level. But we have seen bottoming action in recent weeks that could not hold because the corn and soybean sectors are so weak. It may be later still before we can sustain a rally in wheat and get a chance to sell old crop wheat and look at some price protection on the new crop 2005 wheat.

