



# MARKET INSIGHT

Make solid decisions within a shifting market.

*Commentary by Troy Marshall, American Angus Association*

**I**t is nearly impossible to look ahead to the remainder of 2021 and 2022 without discussing what occurred in 2020. 2020 was a historic year that will long be remembered.

In some respects, it was an anomaly and, as such, has little bearing on the future. Yet 2020 was highly informative and helped highlight trends that will continue to transform our industry. It has shown us that quality continues to be the single biggest economic driver in our industry, and it illustrated the need to manage risk.

Furthermore, it showed us that risk mitigation extends well beyond the classical thought process regarding risk. Risk management includes utilizing the futures and alternative pricing methods, but it also includes having superior genetics, improved management, increased market flexibility and market access.

Many of the market disruptions and signals were the result of a once-in-a-lifetime event created by the global pandemic that disrupted the world's economy and everyone's daily lives. I think it can be said that the second half of 2021 is one of transition where we stop simply grinding our way through the myriad of problems created by the pandemic and once again begin to look toward building a more positive future.

## **Lasting trends**

2020 also changed our world and highlighted some significant trends that will have lasting ramifications on our industry.



PHOTO BY WHITNEY WHITTAKER

Perhaps more so than at any time in our history, predicting the future is tied to understanding recent events and how they have changed both the trajectory and speed of change. The “black swan” events that have occurred in the last several years (packing plant fire, global pandemic) have provided some valuable lessons for the industry.

A key lesson is that while we are pretty good at predicting internal drivers, outside forces have a big and growing effect on our industry. Understanding societal changes and changes in the political environment are important and tougher to predict than things like supply and demand.

As important as it is to understand these outside forces, it is possibly more important to be flexible and open-minded enough to adapt to these changes as they occur.

If I had stood up in an industry meeting 10 years ago and predicted that we would be selling more *Certified Angus Beef*<sup>®</sup> (CAB<sup>®</sup>) brand product than USDA Select, or that the number of cattle grading USDA Prime would more than double in five years, I probably would have garnered a few condescending nods. I wouldn't have been labeled *crazy*, but probably *more than a little naïve*.

If somehow, I would have had the foresight to proclaim that we would see the hotel, restaurant and institution (HRI) trade shut down, that our export markets would

basically disappear, and that the global economy would face difficulties not seen since the Great Depression as a result of a global pandemic, I'm guessing they would have written me off as they elevated me from the *naïve* to the *radical* category.

Furthermore, if I would have had the foresight to say that these disruptions would highlight the

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problems created by the preceding loss of packing capacity and would back cattle up throughout the entire supply chain, resulting in significantly increasing days on feed and tonnage, reducing leverage, and decreasing prices for cattlemen, I'm guessing they may have pulled me off the stage altogether, having progressed from *naïve* to *radical* to *lunatic*.

It was Albert Schweitzer who said, “An optimist is a person who sees a green light everywhere, while a pessimist sees only the red stoplight ... The truly wise person is colorblind.”

Not only did those negative events occur, but some interesting positives emerged from them that nobody would have predicted.

### Unexpected demand

One of the more interesting and unexpected lessons was that despite increased tonnage and devastating economics in most of our key markets, the demand for high-quality beef continued to grow.

Few would have argued if one said the demand for and premiums for high-quality beef were tied to

disposable income and the overall confidence and performance in the industry. Few would have disagreed that demand for high-quality beef was tied to the export markets, and especially exports to Asia. Nor would they have questioned the thought that the primary outlet for higher-quality beef products would be through the HRI side of the business.

Yet, we put more high-quality beef in the retail case than we ever had in history, and a whole new generation of consumers not only learned how to prepare our product at home, they learned the value of high-quality beef to the overall eating experience.

Additionally, for the first time in most consumers' lives, they saw empty food cases and grocery store shelves. In many cases it changed perspectives, not just about having access to and the importance of their food supply, but also in regard to what percentage of their budget they were willing to allocate toward food.

A good friend who resurrected a failing marriage told me you don't know how important your family is until you realize you could lose it. America has a newfound appreciation for food and for the quality of the beef they buy.

### Demand trending higher

When you look at demand in general, nearly all the indicators are pointing in a positive direction, as overall beef demand is improving, especially for high-quality beef.

In the first half of 2021, we have started to see export markets rebound. While the HRI trade remains challenging, there is a growing sense of optimism. As the economy reopens, experts are

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expecting to see a boom in demand at the restaurant level. In fact, many prognosticators are comparing the post-pandemic time frame to the roaring '20s, when there was an explosion of demand as consumers felt the need to make up for lost time.

The beef demand index is already at record levels, and every indicator of beef demand is pointing in the right direction. Admittedly, this demand growth may be a little hard to maintain, as the amount of

stimulus that was created to help the economy survive the pandemic cannot be sustained.

### Supply trending in right direction

The supply side looks almost as good as the demand side of the equation. The industry posted smaller calf crops in 2019 and 2020. As a result, we have seen cattle outside of feedlots and placement numbers start to decline. In addition, we have made a lot of

progress in working through the backlog of cattle that was created with COVID disruptions, and the trendline for carcass weight is moving back toward trendline averages.

Additionally, heifers as a percent of replacements and cow slaughter numbers point to stable to declining cow numbers. Certainly, we have several months of ample supplies and historically heavy out weights, but again, the trend is our friend when it comes to the supply situation looking forward.

Of course, there are some negatives in the marketplace, as well. Corn continues to run well above year-ago levels. South American production concerns and export demand (China) are expected to keep prices elevated in the short term. As we head into the summer months, inevitably we will all be watching the actual planted acreage numbers and how Mother Nature treats us through the crucial growing phase.

I'm not sure if one should characterize the beef-on-dairy revolution as a positive or a negative. Like the issue of packer profits and packing capacity, it is simply an example of the market responding to obvious market signals.

If one wants to argue that a rising tide raises all boats, there is certainly plenty of evidence suggesting that as the overall quality of the product we offer to consumers grows, beef demand grows, as well. Like the economic signals that have continued to push for increased growth and carcass weights, you can argue whether the trend is good or not; but what is undeniable is its inevitability.

What we can say with certainty is



PHOTO BY JD ROSMAN

The marketplace has always wanted more pounds of high-quality product, produced more efficiently, and that hits consumer demand/targets more consistently.

that around 6 million head of cattle that were producing what the marketplace designated as an inferior product have been upgraded substantially, and that will lead to more competition at the upper levels of the market, along with more total tonnage.

The key takeaway message for the cow-calf industry is that we must up our game when it comes to genetics, management, documentation and the formation of supply chains that consistently hit consumer targets. The bar has been raised.

In addition to market fundamentals, one must look at how efficiently the market is performing and how it may evolve in the future. The black swan events in the marketplace helped make it clear that the removal of excess packing capacity had a price. Through the course of the last 24 months, the leverage in the marketplace shifted dramatically toward the packing industry, with the disruptions to packing capacity leading to historically unprecedented margins for the packing industry.

Depending on your perspective, the profits the packing industry has enjoyed the last 24 months are immoral and obscene, or they simply illustrate the power of the free markets. Record profits will create an environment in which we will see an expansion in packing capacity that nobody would have predicted. To illustrate just how significant the incentive has been, we are seeing plans to increase packing capacity from existing

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players, as well as outside entities.

To be transparent, I tend to believe that these two perspectives are not mutually exclusive and, in fact, tend to be 100% accurate if obscene and immoral is not interpreted to be nefarious. The trouble with the messiness and inequity that comes about when the market must send signals to correct the mistakes of the past is that we tend to get angry at the market. We would be better served to direct our anger toward the shortsighted policies and decisions that got us to this point.

In general, as we look forward in the short term, most of the indicators are positive for cow-calf producers and decidedly so from a midterm perspective. This is good news for the cow-calf industry, especially for those producers who are producing above-average genetics for quality, yield and production efficiency. The marketplace trends are well-established and easy to discern.

The marketplace has always wanted more pounds of high-quality product, produced more efficiently, and that hits consumer demand/targets more consistently. The tools to breed better cattle have been geometrically improving, accelerating the possible rate of improvement to levels we have never seen before. Getting better is no longer sufficient. We must be

improving at a faster rate than the average producer to maintain one's competitive position.

Quality, salable pounds and efficiency remain the key drivers, but we are seeing the

consumer show willingness to reward those who raise cattle in certain ways (sustainability, animal welfare, and environmentally friendly). For a long time, we have simply asked the consumer and the supply chain above us to trust us that we had good cattle or raised them right. Until recently that was largely sufficient.

Now the marketplace is starting to demand, or at least reward, that we document and verify the genetics, the management and the story of how our product is produced. While the fundamentals of supply and demand are trending in our favor, the level of protein competition globally and within our own industry is growing at an unprecedented rate, creating an environment where there are both significant opportunities and threats for the cow-calf industry.

Market averages, actual price levels, market volatility, price trends and risk exposure were the key drivers for cow-calf producers looking to create a strategic marketing plan in the past. While these remain important, genetic merit, market access, market flexibility, and response to market signals have become the primary determinants of success. █

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Editor's note: Troy Marshall is director of commercial industry relations for the American Angus Association.