Shifting Tides

Evidence points to a climate-based cattle cycle, spelling optimism for coming year.

by Paul Dykstra, Certified Angus Beef

A smaller cow herd and strong beef demand has been a steady theme several years in a row, and it holds true for the 2023 market wrap-up, as well. Not all components in the beef supply chain are perfectly aligned, yet factors challenging the cattle supply continue to present opportunity and reason for optimism.

Prices for all classes of cattle advanced again in 2023 as the nation's cow herd contracted for the fifth year from the 2019 cycle high. Native feeder and fed-cattle head counts followed suit, adding significant, needed gross revenue gains for cattlemen as demand outpaced supply.

Input costs such as labor, fuel and equipment nipped at the heels of larger revenues as interest rates for the most part increased throughout the year. Even so, the beef business delivered on anticipated highs in 2023 while dealing with the ever-present challenges typical of the trade.

As the cow herd goes

Profitability tends to drive growth and decline in most industries as money flows to where it is best suited. Yet agriculture, particularly the cow-calf sector, more often tends to shrug off losses, even simply reallocating ownership of land or cattle during sustained poor economic periods. In many diversified enterprises — crops and cattle, for instance — cattle are often a byproduct of land ownership.

The classic "10-year cattle cycle" was typified by the expansion or contraction of the nation's cow herd, due primarily to changes in profitability. Periods of greater profitability resulted in overexpansion; periods of sustained losses similarly drove contraction beyond equilibrium.

Yet, the modern era may be defined by significant changes in beef cow numbers driven primarily by moisture conditions. A cycle of drought, moisture recovery and a return to drought is a simplistic depiction of trends driving cow herd size for the past 15 years.

Of course, the size of the cow herd and subsequent calf crop is quite influential on prices. Thus, a weather-driven cycle results in economic drivers — and the two are never uncoupled for long.

As of this writing, the January 2024 predictions call for a more than 2% smaller beef cow herd than a year ago at 28.3 million head. Major cow-calf states such as Oklahoma, Kansas, Missouri, Nebraska and Texas experienced drought in 2023. Yet, California and many other Western and north-central U.S. regions that were previously affected by drought in 2022 improved significantly.

In total, spotty but severe droughts in recent years across a broad scope of regions, coupled with the upside-down profit equation that these conditions created, have driven cow numbers below their 2014 cycle low.

Opposing forces

The cumulative four-year contraction of the cow herd pulled fed-cattle head counts 3.2% lower than the prior year in 2023, causing the expected shift of leverage from the packing sector to the feeding sector. Fed-steer prices had already pushed 18% higher in 2022 vs. 2021, presenting a good start to 2023 with a $157-per-hundredweight (cwt.) live value in January. Tighter year-over-year supplies, however, drove weekly prices rapidly higher to their historic record of $188.75 per cwt. the week of June 5.

This was fortunate for many cattle feeders who had feeder-cattle purchases placed against this and future marketing dates based on breakeven projections as high as $190 per cwt. This level was never realized in the 2023 cash market, although weekly averages through the middle $180-per-cwt.

PHOTOS BY SHAUNA HERMEL

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PHOTO COURTESY OF CERTIFIED ANGUS BEEF

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range remained intact through October.

Escalating fed-cattle prices pinched packer profit margins in the second half of 2023, with their net returns in the weekly spot market fluctuating above and below breakeven. The tighter fed-cattle supply forced a smaller weekly fed-cattle slaughter pace for much of the year, with Saturday shifts either foregone or dramatically reduced.

Late in the year, when market-ready cattle were more numerous, packers continued to restrict the harvest pace to push boxed beef prices upward and hold fed-cattle prices lower. The tactic was more successful in suppressing cattle input cost than it was on the cutout value side of the equation.

November and December 2023 dealt cattle feeders an unexpectedly 8% lower trend in fed-cattle prices during a period typified by an average 8% increase in prices the previous five years. Carcass cutout values did not post their typical rally in November, slowly drifting lower from their October highs, when the comprehensive cutout averaged more than $3.00 per pound (lb.).

This level was simply not sustained through November, as consumer inflation concerns pushed back on chuck and round prices through reduced demand even though rib and tenderloin values soared to new seasonal highs.

At the same time, larger-than-expected placements in the October and November *Cattle on Feed* reports bolstered total "on feed" numbers. The investor, or "funds," segment withdrew interest in long positions in Chicago Mercantile Exchange (CME) live-cattle futures. The rapid sell-off pressed futures-contract prices toward a dramatically oversold position, much lower than cash fed-cattle prices for the near-term December live-cattle contract.

This overcorrection of the market reset all cattle values to a much lower plane in both the futures and cash markets. Spring beef demand holds the eternal promise for the market to slowly reclaim the pricing power that smaller cattle numbers commanded early last fall.

Cutout and carcass trends

Boxed beef demand tends to decide the fate of upstream suppliers. The size of the proverbial "slices of pie" continues to wax and wane in each sector, and the gross value of the end product determines how big the pie is to split among all. It's well-documented that as quality grade has rapidly elevated, so has consumer satisfaction.

However, high retail prices coupled with inflation were headwinds in 2022 and 2023, according to Glynn Tonsor, ag economist at Kansas State University. A lower trend in beef demand shouldn't leave an exaggerated negative sentiment on the beef market, however. The magnitude of the demand uptrend since the mid-1990s has been overwhelmingly large on the larger backdrop of history.

Federally inspected beef production was down 2.7% in 2023, coming off the record all-time high 2022 production of 27.8 billion lb. With the cow herd and fed-cattle harvest nowhere near historic highs, the long-term 5-lb.-per-year upward trend in fed-cattle carcass weights has underpinned beef tonnage despite fewer animals in the supply chain. Record weights late in 2023 placed steer carcasses at their 942-lb. heaviest. Even so, harvested head counts did not keep pace with 2022 totals.

Feedlot cost of gains projected in a range around $115 per cwt., due to cheaper corn costs, should incentivize cattle feeders to add weight in 2024. This combined with the smaller cattle supply and high replacement

Continued on page 110

cattle costs will add days to the average feeding phase.

Carcass quality grade started the year strong with the USDA Choice grade percentage trending record-high February through May. That shifted by June as the Choice grade slipped below the 2022 trend and remained slightly depressed through year's end, most notably beginning in September.

Even as the Choice grade struggled to keep up through the second half of the year, the share of Choice carcasses qualified under USDA-certified Premium Choice programs jumped 1.6 percentage points vs. 2022. With 32.1% of Choice carcasses fitting this category, the year's average bested even 2020's record-setting all-around quality grade percentile mix.

That marbling helped hold production volume higher for the *Certified Angus Beef* ® brand (CAB®), along with other brands in the category. For the calendar year, CAB carcasses numbered just more than 112,000 head per week, 36.4% of Angus-eligible carcasses and 23% of total federally inspected fed cattle.

The early-in-the-year Choice grade gain was partially given up by USDA Prime in the same period. The most premium category tracked just below the 2022 average through April before mounting an impressive turnaround through year's end.

Average Prime production for 2023 ended at 9.2% of fed-cattle carcasses vs. 8.9% the prior year. Smaller slaughter pulled the annual Prime tonnage difference 2.2% lower in 2023.

Premiums paid to feedyards for carcass quality drive demand for premium genetics and best management practices in the supply chain. Consumer preference for tender, juicy, flavorful beef has created further segregation in carcass values in recent years with marbling as a key driver.

Many agree that the lower one-third of USDA Choice product today has replaced USDA Select as the ubiquitous commodity grade, comprising roughly 49% of fed-cattle carcasses. Yet, when it comes to value-based carcass pricing, the bellwether Choice-Select spread is often the most seasonally variable component of the quality side of the carcass payment calculation. This lends significance to the record-wide 2023 Choice-Select spread of $22.12 per cwt. on packer grids, according to USDA.

CAB grid premiums were, on average, lower due to steadier supplies than total Choice carcass throughput. Priced in addition to the Choice premium, CAB carcasses were nonetheless quite valuable, with the $4.65-per-cwt. kicker over Choice bringing their net price to $26.77 per cwt. above Select.

USDA Prime grid premiums pulled 22% lower last year as beef cutout values soared to record highs. In speculation, the compression of the Prime premium makes sense in the wake of record beef prices on the year coupled with consumer inflationary concerns.

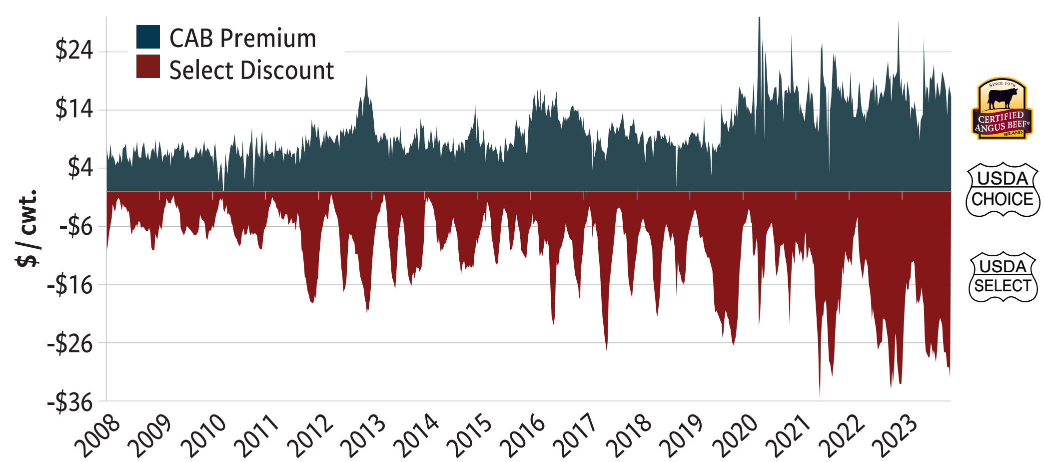
Anecdotally, our retail and foodservice partners give all indication they have no intentions of backing off quality. In fact, they have concerns about being able to supply their needs in the coming year.

The moral of the story: Even though carcass quality has been in vogue for some time, and though we've made tremendous gains, evidence from 2023 and future outlooks suggest cattlemen would be wise to stay the course.

Even as escalating retail beef prices present challenges to beef consumers, the outlook for 2024 is quite positive given the advancements achieved in beef demand. Cattlemen are not yet rebuilding the cow herd, and it appears that it will be a slow transition to growing the nation's herd. ABB

Editor's note: Paul Dykstra is director of supply management and analysis for Certified Angus Beef.

Fig. 1: CAB and USDA Select cutout values vs. USDA Choice



SOURCE: Urner Barry.

Fig. 2: Fed steer and heifer slaughter