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by **PAUL DYKSTRA**, *Certified Angus Beef LLC*



Seismic shift in 2016 beef cattle markets

The shifting tide for beef markets in 2016 was pulled by the cattle cycle's return, with its economic tradeoffs always seeking equilibrium. The year opened with foreshadowing — if not dread — in view of the 31% plunge in fed-cattle prices from the January 2015 high to its December low. The only wild card was just how deep that expansion-induced gash would go as leverage shifted from producer to processor.

It went deep, with the full impact coming home to roost. Cow-calf

operators had responded swiftly to the price signals that begged for more calves as early as fall 2013. By the start of last year, USDA reported beef cow numbers restored to a pre-drought 30.3 million, matching the early 2012 estimate after gaining 4% in just two years. CattleFax said 58% of the growth went to restocking of the drought-affected Southern Plains. Further expansion in the past year was expected to add another 850,000 cows (2.7%) in the January 2017 USDA report.

Responding to change

Declining capacity at the packing level during the past couple of years set the stage for a significant leverage shift as fed-cattle supplies rebounded in 2016. Red ink was blamed for plant closures in Texas, Iowa, California and Minnesota, but the resulting bottleneck as cattle numbers grew meant full utilization of packing capacity in 2016. Packers achieved record profits near \$200 per head at their widest, with months of positive margins on the growing supply for a 6.1% increase in steer and heifer harvest, averaging 463,000 head per week.

The record heavy carcass weights of 2015 continued through the first quarter of 2016, up another 16 lb. year-over-year and raising that bar still higher. Fed supplies became current through the second quarter, even as the previous year's expanded calf crop yielded an extra 24,000 head per week last spring, bringing carcass weights lower and in line with 2015.

Carcass weight trends in the second half of 2016 were kept in check by the declining fed-cattle price from \$120 per hundredweight (cwt.) in early July to the low of \$97 per cwt. in mid-October. Cattle feeders sold willingly and early throughout that slide, at consequentially lighter pay weights. Although seasonal patterns expect the heaviest carcass weights each fall, the second half of 2016 finally produced an average 8-lb. decline from 2015. USDA reported steers ranging from 880 lb. to 914 lb. for the third- and fourth-quarter averages, respectively. In the end, 2016 still recorded a 1-lb. increase in carcass weights and 6.12% more total beef from fed cattle.

Add that to a 4.7% increase in the cow harvest for a net per-capita increase of 1.7 lb., according to USDA and CattleFax. Fortunately, the per-capita net beef trade made an offsetting move, up 1.5 lb. on increased exports and decreased imports. Even so, the cattle feeder's share of the composite cutout

declined to 53.8% compared to 57.6% in 2015. End-user beef prices may line up closer to cutout values in 2017, but with more cattle on feed expected, few expect any shift in favor of cattle feeders.

As the nation's production sectors have become adept at maximizing pounds per head, they continue to improve product eating quality, as well. USDA quality grade measures have proven that what was once unthinkable is now the norm in terms of U.S. average quality grade levels.

We have reported annually on the tremendous era of increases in U.S. Choice production since 2006, rising from that modern-day low of 51% Choice to the 2016 figure of 70% — up just a point, but continuing the trend. The Prime grade also increased by half of a point to average 5.56% in 2016, a much larger proportional change in a much smaller grade category.

Heavier carcass weights, refined grading technology, grade-friendly

implants and use of distillers' byproducts helped those trends. They were enabled by seedstock producers who responded to demand with a greater focus on carcass traits and marbling.

The number of branded-beef labels keeps growing as processors and end users collaborate to extract value from all kinds of beef. The 203 USDA-certified programs in 2016 included 147 that specify Angus-type. First and largest, the *Certified Angus Beef*® (CAB®) brand marked 12% growth in annual fiscal sales on the year, surpassing 1 billion lb. with 10 consecutive annual records.

Of course, the rapid expansion brought more CAB-eligible cattle. The identified portion of fed steers and heifers (predominantly black-hided) came in at the five-year average of 62.5%, but up a little from 2015. Of those eligible, a record 28.9% were accepted under the brand's 10 carcass standards, up from 27.3%. This high-water mark captured roughly 16% of all

CAB STAFF CONTACTS

206 Riffel Rd., Wooster, OH 44691-8588;
phone: 330-345-2333; fax: 330-345-0808
www.cabpartners.com

John Stika, president
Brent Eichar, senior vice president
Tracey Erickson, vice president, marketing
Mark Polzer, vice president, business development
Mark McCully, vice president, production

SUPPLY DEVELOPMENT DIVISION

Justin Sexten, director
Marilyn Conley, administrative assistant
Kara Lee, production brand manager
17309 Dakota Dr.,
Leavenworth, KS 66048
Paul Dykstra, beef cattle specialist
782 5th St., PO Box 856,
Chappell, NE 69129
308-874-2203
Larry Corah, retired, consulting

INDUSTRY INFORMATION DIVISION

Steve Suther, director
16360 Victory Rd., Onaga, KS 66521
785-889-4162
Miranda Reiman, assistant director
75845 Rd. 417, Cozad, NE 69130;
308-784-2294
Laura Conaway, producer communications specialist
PO Box 1073, DeLeon Springs, FL 32130
386-316-5138

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Fig. 1: U.S. fed-cattle harvest vs. Choice production

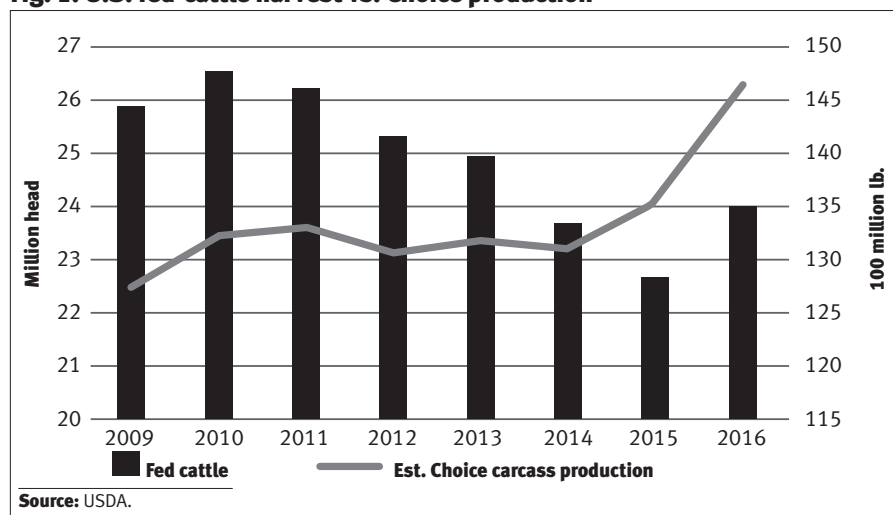
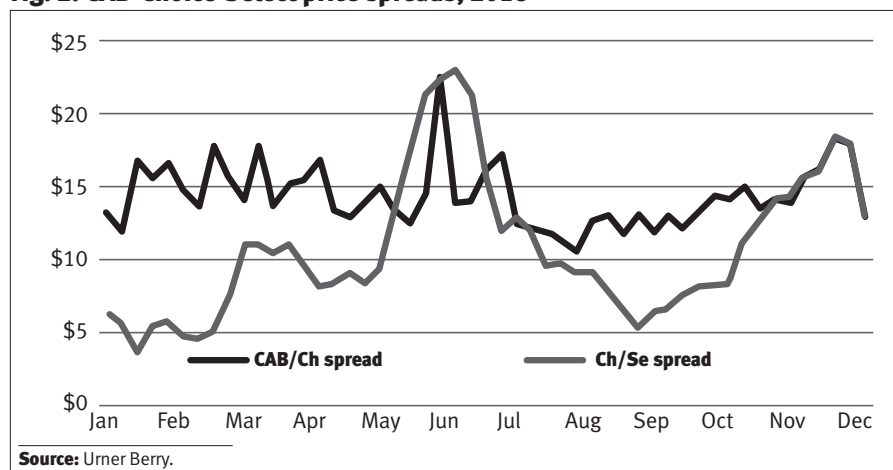


Fig. 2: CAB-Choice-Select price spreads, 2016



U.S. fed cattle, about 73,000 head per week.

Marbling remains the factor excluding most eligible carcasses in their CAB bid. The brand's carcass-weight ceiling of 1,050 lb. and ribeye-area requirement between 10 and 16 square inches have grown in significance as finished weights crowded and spilled over the boundary. Consequently, noted quality grade improvements and lighter year-on-year finished weights in 2016's second half teamed up to boost the annual CAB acceptance rate.

While the pressure came off of cattle supplies in 2016, this was still the third-smallest annual harvest since 2000 in terms of head count. The 23-million-head harvest of 2016 was 23.4% smaller than that of 2000. The emergence of record sales volume in premium branded product during historically low cattle supplies shifted the beef market reality.

Even so, the question of market demand has not always been clear, with producers in all sectors varied in their approach to commodity vs. quality focus. That difference remains today, but market signals have become clearer in the face of a growing proportion of high-quality beef compared to Select and "no-roll."

The Choice-Select production ratio reached a modern-era record of 3.5 to 1 last year, while the USDA-reported price spread between those grades increased \$1.80 per cwt. above the 2015 average, topping the 5-year average by 45¢ per cwt. Urner Barry further quotes the CAB-Choice cutout spread at \$14.44 per cwt. in the 2016 average weekly spot market, a 67% increase in the premium above low Choice compared to 2015.

We're often asked, "How large a proportion of quality product will the market absorb at a premium?" The data continues to remit an ever-growing demand as we summarize price and quantity.

Price discovery

Another theme of 2016 was that of price discovery for fed cattle. The long-term decline in bid-and-ask "cash" trade volume caught a break with the Internet-based Feeder Cattle Exchange's fixed-time bidding portal on Wednesdays. Primarily available from September on, it included as many as 12,000 head of fed cattle.

Formula-based sales remain the majority of the market, though often with some tie to carcass quality and yield. USDA reported higher premiums paid for cattle sold specifically on a carcass-value basis, in both quality and yield grade categories. The CAB premium for the year came in at \$4.50 per cwt., up 38¢ and paid on top of any Choice premium. The top end of the range for CAB reached north of \$11 per cwt. on one grid when supply and demand lined up perfectly in that market-sensitive pricing format. Yet greater availability of Prime carcasses pushed premiums for the richly

marbled product lower by a dollar, netting an average of \$15.02 per cwt.

Cutability has become an issue on the heaviest, longest-fed cattle in the past two years with more Yield Grade (YG) 4s cropping up at times. Packers consequently turned the knob up on premiums for YG 1 and 2 carcasses to average \$5.71 per cwt. and \$3.03 per cwt., respectively. Those yield grades

gained nearly a dollar of added focus back in August of 2015, which remained steady from there forward. A dollar and a half adjustment to the YG 4 discount coincided with those changes, increasing the 2016 average discount to \$9.79 per cwt.

For all of the mostly negative drama that characterized the year, it ended on relatively solid footing, with boxed-

beef cutout values and cash fed-cattle prices much improved. There will be highs and lows in the new year, but the beef business remains an exciting and worthwhile endeavor, winning favor with flavor and higher quality each year.



Editor's Note: Paul Dykstra is a beef cattle specialist for Certified Angus Beef LLC.