

Bulls, Bears And.... Hogs?

*Hog Butcher for the World,
Tool Maker, Stacker of Wheat,
Player with Railroads and the Nation's Freight Handler;
Stormy, husky, brawling,
City of the Big Shoulders:*

– Carl Sandburg, "Chicago," 1916

An inspirational episode of Roman history involved Cincinnatus, a farmer-turned-soldier, who upon achieving victory laid down his arms rather than accept political power. A statue of George Washington in Richmond, Virginia, depicts the Father of Our Country as the admirable humble citizen for whom the modern-day city of Cleveland is named.

Well, it looks as if history is about to repeat itself here on the shores of Lake Michigan. The Chicago Mercantile Exchange has turned to Terry Duffy, a longtime broker in the CME's Lean Hog futures pit, as its new leader for the 21st century (AD, in case you're wondering). I bet those city slickers in the wicked canyons of Wall Street are shaking in their top hats and morning coats as you read this. They no doubt are biting their well-manicured nails and twirling their perfumed locks at the thought of doing battle with this modern yeoman hero, this Pasha of Pork, this Sultan of Swine, this Terror of the Trough.

Porky's

Stop your laughing right now, pals and palettes. Hog farmers have been adopting the large-scale industrial production techniques long familiar to the poultry industry and such powerhouses as Tyson Foods and Sanderson Farms. The improvements from genetic engineering are just beginning: Corporate hog farms in Alberta, for example, are now able to adjust the fat content of certain cuts of meat to serve their Asian export markets better.

Yes, hog production is a big business getting bigger: The present farm bill before Congress – laden with pork, of course – will serve to prop up the prices of farm land and increase food surpluses, and therefore drive even more of those storied family farmers into urban perfidy. The economics of industrial hog production differ from those of the family farm; the corporate farm has huge fixed costs that must be amortized via high levels of production regardless of marginal revenue. This is the microeconomics of the classic oligopoly – think of OPEC nations continuing to produce crude oil when marginal revenue falls below the cost of production – and it drives producers toward ever-greater efficiencies.

Inflation-Adjusted Spot Month Hog Futures

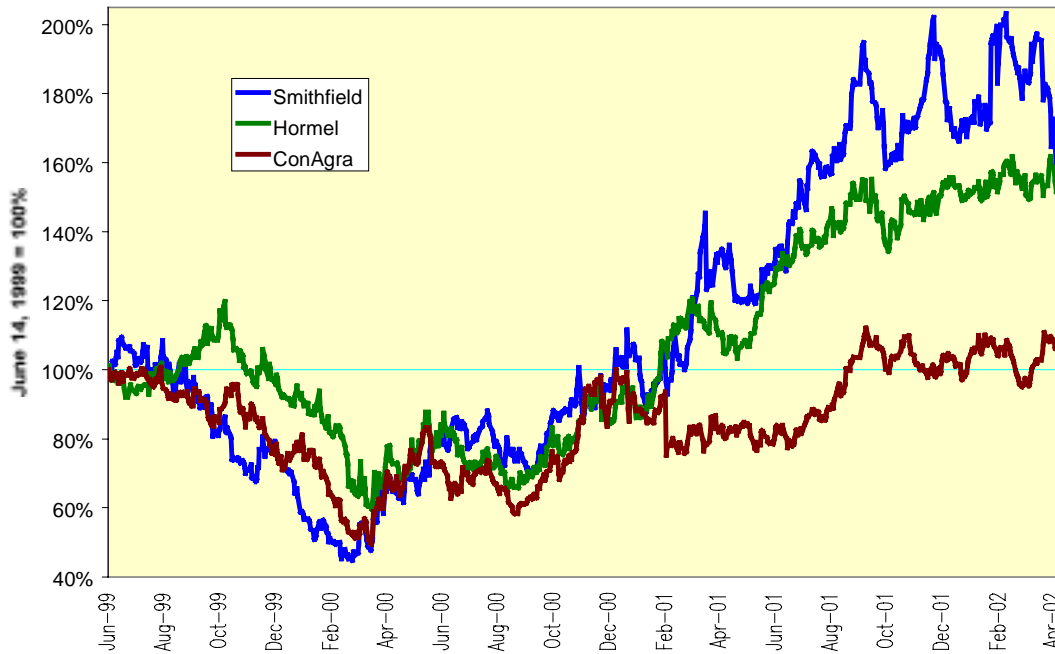


The result of all this will be a continuation of pork prices' relentless decline. In December 1998, farm hog prices fell below 10 cents a pound, a level not seen since the late 1940s. Should you care? No, you are an investor, not a social worker. If it is true that supermarket prices for pork have not fallen as much as feedlot prices and that the packer is capturing the economic rent of low hog prices, you have a simple solution: Buy the stock of the packer. Capitalists are supposed to capitalize on opportunities like this, right?

Where's The Pork?

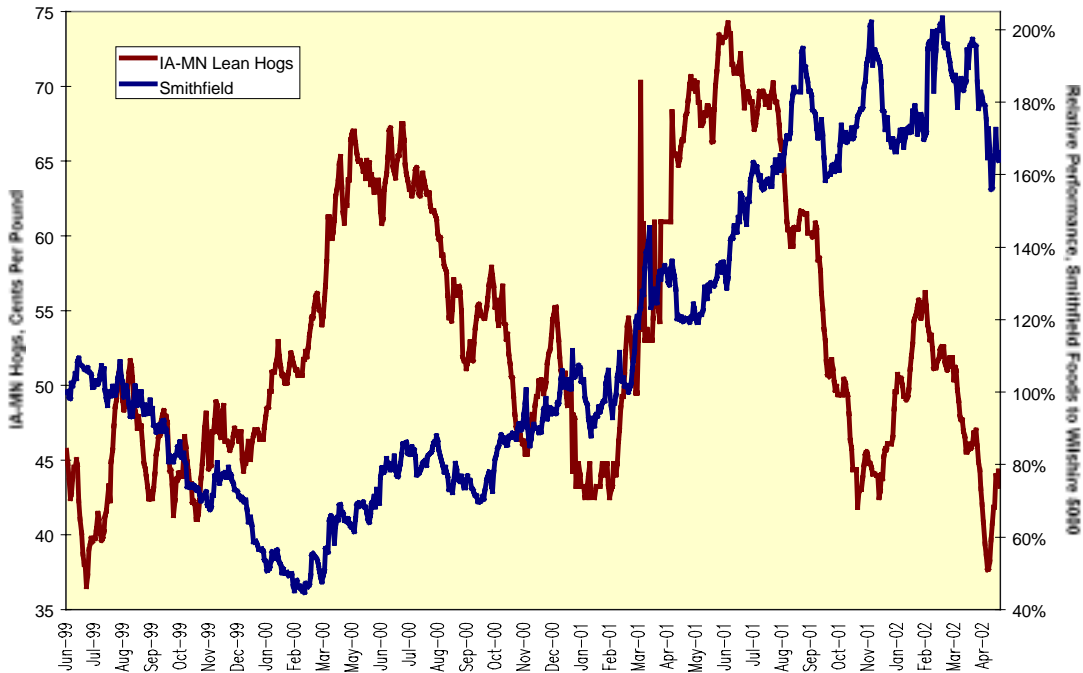
This concept has worked fairly well over the past three years, especially for the ham-oriented Smithfield. But the shares of meat packers such as Hormel Foods (the developer of Spam, please draw your own conclusions), Smithfield Foods and even those of integrated producers such as ConAgra have been taking it on the chin with just about everything else in this Springtime of Our Discontent.

Relative Performance of Pork Packers To Wilshire 5000



The strongest performer in this trio, Smithfield Foods, has been able to outperform the broad market pretty steadily since the onset of the bear market in early 2000, regardless of movements in the cash price of hogs, here represented by the USDA's daily quote for the hog-infested Iowa-Southern Minnesota region.

A Deal With A Squeal



However, in homage to Mae West, too much of a good thing may not be wonderful. Low raw materials costs affect processors adversely when the price of finished products fall. Just this past week, Hormel Foods issued a profit

warning, citing a glut of meat and poultry supplies. Worse, the Russian ban on poultry imports that followed the ill-advised steel tariffs has eliminated one of the largest sources of overseas demand for American meat products; [this was a wholly predictable](#) consequence of the Bush administration's turn toward protectionism.

A Sloppy Market

One thing all of us should have learned over the past two years is that trading by hope doesn't work all that well. We stuck with technology and telecommunications on the logic that people would be using more computers and gizmos and sending more data flying around to who-knows-where. However, these have been dreadful stocks. The pork packers, poultry processors and other provision purveyors will be serving up lots of meals, to be sure. But until they enjoy another pair of P's, pricing power, they are going to be caught in the same profit purgatory as their more glamorous cousins.

What's the solution? First, write your elected officials and tell them, for once in their lives, to knock it off with the farm welfare. It does far more damage to the agricultural sector than it does good, no matter what the intention. And second, protest protectionism. No exports can mean no profits for a lot of American companies. An outrage is being perpetrated in Washington, and as Edmund Burke said, "All that is necessary for the triumph of evil is that enough good men do nothing."