FEEDER-CALF MARKETING GUIDE

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NAVIGATING THE CATTLE CYCLE

Charting the Course for the Cattle Cycle

Prices predictably ebb and flow with supply and demand, but black swans can break the pattern.

by Patrick Linnell, CattleFax

The U.S. cattle industry has followed a cyclical pattern for well over a century, even throughout the many shocks and changes that have occurred over the decades. As the saying goes, history rarely repeats itself, but it does often rhyme. That is especially true when it comes to cattle cycles, which gives us a guide for market expectations in the years ahead.

What is a cattle cycle?

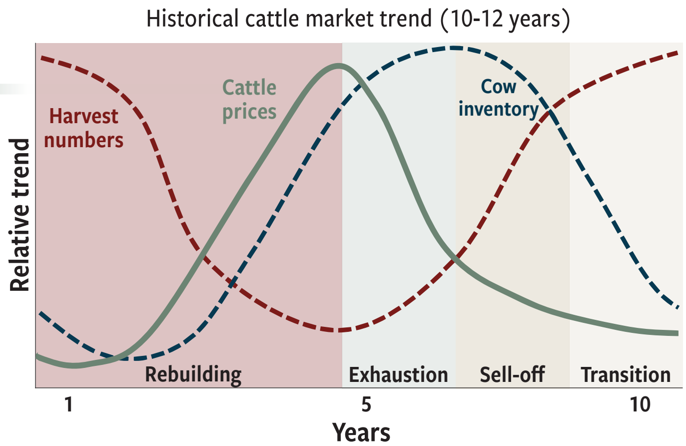
Cattle cycles are driven first and foremost by the price signals of a free-market economy. Periods of tighter cattle numbers result in reduced beef production, higher beef and cattle prices, and strong producer margins.

Producers expand production in an attempt to capitalize on the strong margins. Additionally, some producers may view expansion as a means to reduce cost structure by spreading fixed costs across more cows. On average across the country, producers retain more heifers and cull fewer cows, resulting in an expansion phase.

Eventually the expansion translates to larger cattle numbers and increased beef production, accompanied by lower beef and cattle prices. Profitability for the producer narrows, and cow-calf producers cut numbers. Since there are always wide ranges in margins between producers, typically the higher-cost, lower-margin producers reduce cow numbers the soonest and the most.

Eventually, as cattle numbers and beef production decline, cattle prices

Fig. 1: The historical beef cattle cycle



SOURCE: CattleFax adapted from University of Wyoming.

and producer margins improve, and the cycle starts again.

Typical timing

A typical cattle cycle lasts around 10 years from the low in cattle supplies and high in price to the next low in supplies and high in price (see Fig. 1). Similarly, cyclical highs in cattle supplies and lows in price average about 10 years apart.

The length of time is a simple result of the long production cycle in the beef cattle industry. From the time a producer decides to retain a heifer calf in the cow herd, it takes three years for her offspring to contribute to an increase in beef supplies. Expansion and contraction phases are usually longer than three years because it takes time for enough producers to respond to price signals to meaningfully affect supply. The cow herd is a slow ship to turn.

Unique signature

While the basic template remains the same, each cattle cycle is unique. The influence of moisture on drought and forage conditions has a significant influence on the length and shape of each cattle cycle. Green grass — or the lack thereof — clearly has a huge effect on producers' decisions, affecting the rate of expansion or contraction and dictating the number of cows the nation's pasture and rangelands can support at any given time.

Other factors, many of which are unexpected "black swan" events, can influence cattle cycles and expansion-contraction patterns. The cattle backlog and price drop from the COVID-19 pandemic is likely the first example that comes to mind for many producers. The 1986 dairy buyout program, bovine spongiform encephalopathy (BSE) in 2003, the 2008 financial crisis and Great Recession, and the 2019 packing plant fire in Holcomb, Kan., are other examples of events throughout the decades that influenced the cattle cycle. Unfortunately, most of these events have had negative ramifications for producers.

What about this cycle?

The basic pattern of cattle cycles gives a road map for the years ahead. The cyclical lows in prices (see Fig. 2, page 16) and peak in cattle supplies (see Fig. 3, page 16) occurred in 2019-2020. Since then, cattle numbers have been declining and prices have been moving higher, following the classic cyclical pattern. Prices shouldn't be expected to peak until cattle supplies find a low and begin to turn higher.

CattleFax anticipates several years of tighter supplies remain ahead. U.S. beef cow inventories dropped 716,000 head to begin 2024, the smallest inventory since 1961. Another smaller decline is expected to begin 2025, as USDA reports the smallest number of bred heifers in decades will be entering the mature cow herd this year. This and other data also indicate a relatively small number of heifers were retained from the 2023 calf crop that will be bred in 2024.

Heifer retention is expected to pick up this fall from the 2024-born calf crop. As a result, the U.S. calf crop could grow on a year-over-year basis in 2026 and fed-cattle supplies could grow in 2027. This is the most likely supply pattern from what is known today. But the rebuild could be delayed if the return of *La Niña* restrains producers' ability to restock and retain heifers this fall.

History shows that the exact timing of price highs can vary in comparison to inventory lows (especially in a world of black swans). But, if heifer retention begins in earnest this fall, historical averages would suggest highs in 2026, plus or minus a year.

Anticipating the fall

For many producers, the path from now to the cyclical price peak is less important than the trajectory for prices on the way down once the bull market is complete. Few need reminded of the price collapse in 2015 and 2016 when fall calf market values were cut in half in just two years following the record highs of 2014.

Once the price highs have been

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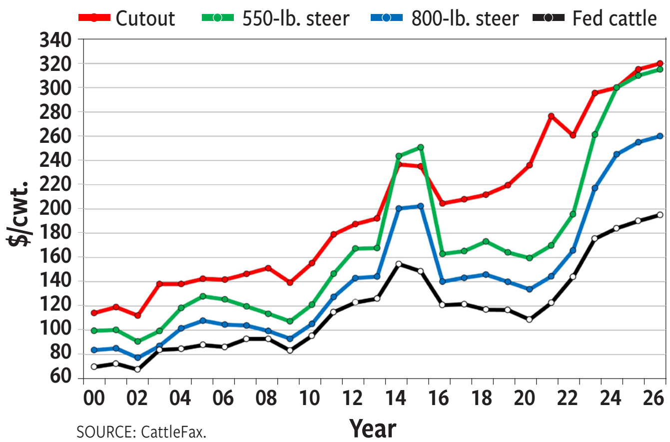
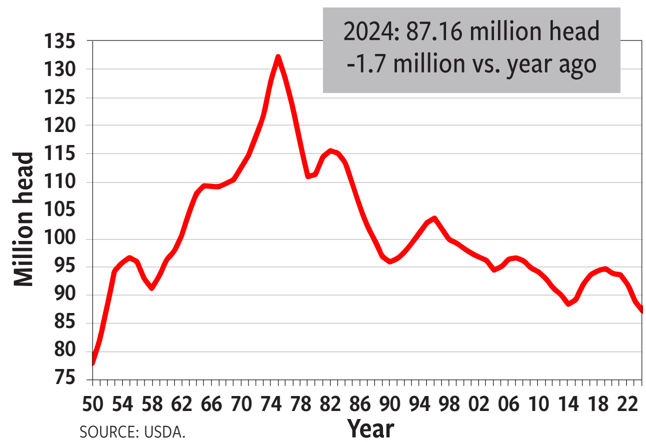
Fig. 2: Avg. annual U.S. cattle prices



SOURCE: CattleFax.

Fig. 3: Total U.S. cattle inventory



SOURCE: USDA.

established, the more likely scenario for this cycle is for a much less abrupt price decline for a few years with prices still holding strong by historical standards. This is primarily driven by the expectation for a slower, more methodical expansion compared to the last cattle cycle.

In the last cycle, calf crops and fed-cattle supplies surged back with a vengeance as the industry expanded at the most aggressive pace on record. The cow-calf sector held back heifers and dropped the cow culling rate at historically extreme levels at the same time.

Another important difference is the packing capacity landscape. In the last cycle, the industry had been closing plants and reducing slaughter capacity in reaction to tight cattle numbers and negative margins. When cattle supplies rebounded, harvest capacity was inadequate and forced a strong utilization rate of the remaining packing infrastructure. The situation was only made worse by a major packing plant fire, COVID-19, and drought-forced liquidation.

Now, for the first time in decades, the packing industry is on a path for a net addition in capacity. Some new builds and expansions have already occurred, with other projects underway and expected to become operational in the years ahead. The packing industry will again face slim margins in the years ahead, but the projects completed and underway suggest that capacity will be there to meet the eventual cow herd expansion.

Restraints to watch

The potential resurgence of *La Niña* and its accompanying drought conditions in the Central Plains could be the most obvious headwind to an aggressive expansion. Only time will tell which regions are affected, and to what degree. Certainly, no two drought cycles are created equal.

Drought aside, other headwinds are likely to restrain the rate of expansion. The laundry list includes age of producer, labor availability, elevated costs and interest rates, capital requirements, market and regulatory uncertainty, as well as urban sprawl and alternative land uses.

All of these challenges may not pertain to every individual operation, but their combined effect across the industry is significant. The influence of these structural issues is highlighted by the modest-at-best expansion so far in regions that were largely free of drought over the last year. These factors are likely to prevent the explosive expansion the industry executed a decade ago.

Current trends indicate that this cattle cycle will be slower to unfold than the traditional 10-year cycle. But, prices will inevitably find a peak as cattle numbers and beef supplies eventually increase again. Prices will then move lower as the cattle cycle continues. However, a slow expansion rate and more gradual supply rebound, as well as more adequate packing capacity, lay the groundwork for a less dramatic price decline on the other side of the cycle. This sets up the upcoming years to remain a strong period for cow-calf margins.

Back at the ranch

The trajectory for prices and margins discussed above indicates that the outlook is still favorable for expansion or restocking from past liquidation. Yes, the best opportunity was a year or two ago (drought notwithstanding). But, a slower expansion suggests it is not too late. Still, the price of purchased females or value of heifers retained from within the herd should be balanced against the expected value of her progeny to determine when female prices are too high to justify expansion.

Whether expanding or not, producers should also consider the genetic direction to take the cow herd to be best positioned for long-term profitability. One trend to keep in mind is the progressively wider ranges in calf prices in recent years, as the market has seen greater value differentiation between calves.

What drives these differences? While value-added programs are certainly one factor, even more fundamental are the value differences along lines of quality and performance. Many calves that bring above-average prices tend to be the ones that are efficient at producing the most pounds of high-quality beef for the consumer.

The consumer continues to show a strong preference for high-quality beef, and that trend is unlikely to change. With these value signals from the consumer, cattle that grade Prime or are eligible for upper two-thirds-Choice programs such as the *Certified Angus Beef*® (CAB®) brand are simply worth more. Pounds pay, but especially pounds of quality. Between wider premiums for the upper tiers of quality and an overall higher market, calves that stay healthy, gain weight efficiently, and produce more pounds of high-quality beef are more valuable from the ranch to the plate and at every point along the way.

While the market on average is expected to stay strong for several years, volatility and uncertainty may not go away. Even if a negative black-swan shock to the market is short-term, the effect can be outsized for a producer who sells once per year, both financially and psychologically.


PHOTOS BY SHAUNA HERMEL

Volatility combined with the higher equity at stake in a higher market increases the importance of risk management strategies. This can include futures, options, livestock risk protection insurance (LRP), or forward contracts. Having flexibility and exploring different marketing avenues and marketing windows, whether via video sales, direct sales or auction markets, is also just good business. What works best varies by operation, but a little attention to risk management and marketing can go a long way toward maximizing the good times in the cattle cycle. ABB

Editor's note: Patrick Linnell is a market analyst for CattleFax.