Iowa Cattlemen's Association

Cattle Market Summary – October 2016

Your Iowa Cattlemen's Association staff and leaders share your frustrations with the current state of the fed and feeder cattle markets. Traditionally, the market moved around $20 per head per week, but in the first week of September, 2016, fed cattle prices fluctuated approximately $70 per head. This volatility is unacceptable for the Iowa cattle producer.

For this reason, your Iowa Cattlemen's Association has been working diligently to discover the root causes of market volatility and reduce market volatility.

Here is a brief summary of the problems we know of and ways ICA is working to solve them.

1. **Electronic Trading (*AKA: High frequency, algorithmic, automated, etc.)* in the live cattle futures contract.**

On July 2, 2015, *Open Outcry,* the 167 year old tradition of trading futures face-to-face via "the pits" - ended at the Chicago Mercantile Exchange. Since then, 100% of futures trading has happened through the electronic trading system known as CME Globex.

Electronic trading was steadily increasing before the pit closed, but many wonder whether the switch to electronic trading has increased cattle market volatility.

1. Market Participants - The effects of speed and participation
   a. Electronic trading may bring liquidity and volume to the contract. But did closing the 'pits' take away the self-regulating aspect of the contract that may have limited volatility in the past?
   b. Has the competition, combined with speed opportunities connected to algorithmic computer programming, led to more fast paced and high frequency market moves?
   c. Is there **market participant intent** behind the high frequency of volatility (spoofing) or is the volatility merely a symptom of an unforeseen consequence of changing the platforms of engagement of the market?

Unfortunately, we don't know the answer to those questions. *The CME has yet to work with the industry to fully analyze the effect of the participants and their behavior on volatility.*

The CME argues that only 10% of market participation is high frequency traders. NCBA and ICA would like CME to release the raw data to a 3rd party auditing service to verify this statistic. The CME states it is unable to release audit trail data for regulatory/confidentiality reasons.

After direct meetings with CME were unsuccessful, NCBA and ICA asked the Commodities Future Trading Commission (CFTC), the governmental agency that oversees the commodities markets, to look into the data. ICA and NCBA traveled to Washington, DC the first week in October to push the CFTC for more information.

Although the trading data has not been released, CME has made two changes intended to decrease the impact of high frequency traders on the cattle markets.

- Message Efficiency Program - Cattle futures were added to an existing CME system capping the number of order updates traders can send in relation to the number of trades they actually execute.
- Limit trading hours - The CME reduced trading hours for its livestock futures and options contracts.

2. **Lack of price discovery across all major cattle feeding regions.**

Over the past several years, the types of cattle marketings (reported through mandatory price reporting) has changed. In the past, most cattle were "cash negotiated," meaning several market participants openly bid on cattle to negotiate the most favorable price for the cattle feeder.

Traditionally, cash negotiated trades have been the hallmark of healthy market price discovery due to the transparent and current nature of which they were reported. Cattle prices were reported through USDA's Mandatory Price Reporting, and all participants had a sound understanding of what cattle were worth at any given time based on many market factors like supply, demand, seasonality, etc.

Currently, 60-70% of Iowa fed cattle are marketed through the cash negotiated market. However, that is not true in other major cattle feeding regions. In Texas and Oklahoma, for example, only 5-10% of cattle marketings reported through USDA Mandatory Price

Reporting are cash negotiated trades. The other 90-95% of the cattle are sold through formula pricing, which typically uses the cash price (determined by the cattle sold on the cash market) plus premiums or discounts for various marketing aspects (delivery distance, carcass quality, ability to commit supply early, etc).

Although cash negotiated transactions are reported through USDA's Mandatory Price Reporting, the details of formula trades are not reported. There is often several weeks between the time a formula trade occurs and the time the trade is reported, which is when the cattle are delivered. This has led to an imbalance in market information - the average cattle feeder in Iowa has much less current market information than the packer, putting the packer at an advantage when pricing cattle.

ICA leaders recognized this problem, developed policy at BeefMeets to address it and successfully championed that policy at NCBA's Summer Business Meeting. The new NCBA policies are:

> **Fed Cattle Price Discovery**
> WHEREAS, all fed cattle producers have a shared incentive to maintain an efficient price discovery process that determines fair market value, and
> WHEREAS, properly functioning cash and futures markets require substantive negotiated trade and transparent distribution of market information, and
> WHEREAS, the bid-and-offer cash fed cattle trade remains the primary base factor for fed cattle value determination on a nationwide basis, including those transacted on alternative marketing mechanisms, and
> WHEREAS, all fed cattle producers have a shared incentive to contribute to accurate price discovery,
> **THEREFORE BE IT RESOLVED, NCBA support initiatives that encourage and increase negotiated cash trade in all major cattle feeding regions.**

In addition to the new NCBA policy, ICA staff and leadership are currently looking into ways to make the formula trades more transparent.

Below is a timeline of ICA actions and results:

- January 2016 - **ICA staff and leaders met with the Chicago Mercantile Exchange (CME)** in San Diego at the NCBA convention. After the meeting, the CME added the cattle futures contract to its Message Efficiency Program and decreased trading hours.
- March 2016 - ICA staff and leaders attended the NCBA Legislative Conference in Washington, DC and met with each of Iowa's congressional delegates to discuss the market instability.
- April 2016 - ICA submitted comments to CME **opposing** the Worthing delivery point discount. CME delayed their decision until after the NCBA Summer Business Meeting (July 2016) due to the "high volume of comments."
- June 2016 - New policy surfaced at Iowa's BeefMeets encouraging cattle producers in all major cattle feeding regions to market 50% or more of their cattle through cash negotiated trade. This policy was directed toward southern states, where only 5% of cattle are marketed through cash negotiated trade, in order to increase price discovery.
- July 2016 - ICA board approved the policy from BeefMeets, as well as policy supporting the delivery point system and opposing discounts to any delivery points, including Worthing.
- July 2016 - **ICA leaders successfully led changes to NCBA policy at NCBA's Summer Business Meeting. NCBA policy now officially supports the delivery point system, opposes a cash settled contract and opposes discounts to any delivery points.**
- August 2016 - Staff and leaders met with congressional delegates at Iowa State Fair and discussed market volatility.
- September 2016 - ICA began facilitating meetings between congressional delegates and cattle producers to highlight the urgency of these problems and work towards solutions.
- October 2016 - ICA leaders traveled to Washington, DC for the NCBA Working Group and to encourage the CFTC to look into CME automated trader data.

If you have ideas or possible solutions that we have not yet explored, please feel free to contact us at 515-296-2266 or iacattlemen@iabeef.org