DATE: February 28, 2014  
TO: Directors & Members  
FROM: Rob Vandenheuvel, General Manager

### MPC FRIDAY MARKET UPDATE

#### CHICAGO CHEDDAR CHEESE
- Blocks: +$.0600, $2.2225
- Barrels: +$.0425, $2.2000

#### CHICAGO AA BUTTER
- Weekly Change: +$.0950, $1.8800
- Weekly Average: +$.0307, $1.8070

#### NON-FAT DRY MILK
- Calif. Plants: Week Ending 2/21 & 2/22, $2.0429, 6,505,028
- Nat’l Plants: Week Ending 2/21 & 2/22, $2.0825, 17,084,214

#### DRY WHEY
- Calif. Plants: Prior Week Ending 2/14 & 2/15, $2.0360, 8,121,113
- Nat’l Plants: Prior Week Ending 2/14 & 2/15, $2.0766, 15,668,096

#### FRED DOUMA’S PRICE PROJECTIONS...
- Feb 28 Final: Quota cwt. $23.38, Overbase cwt. $21.68, Cls. 4a cwt. $23.11, Cls. 4b cwt. $21.14
- Last Week: Quota cwt. $23.34, Overbase cwt. $21.64, Cls. 4a cwt. $23.03, Cls. 4b cwt. $21.12

### MARKET COMMENTARY: (By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)

#### Milk & Dairy Markets

Amidst a flurry of ever higher bids, CME spot butter climbed a dime on Friday after 19 trades. It settled at $1.88/lb., up 9.5ȼ from last week. Grade A nonfat dry milk (NDM) was quieter. It closed at $2.04, down a half cent from last Friday. Spot Cheddar continued to rise. Blocks added 6ȼ, while barrels gained 4.25ȼ. They settled at $2.2225 and $2.20, respectively. The block market has now spent an impressive 47 consecutive sessions above $2.00/lb., the second longest such streak on record. Class III and IV futures contracts closed mostly 20-40ȼ higher than they did a week ago.

For some time, the butter market has been the weak leg in the dairy complex. That is not to say that butter prices have been anemic; rather, butter has seemed a follower in the broader dairy markets’ bull run. But late this week, the cream rose to the top. Butter’s resurgence was likely driven by news that China imported an astounding 275 million lbs. of whole milk powder (WMP) in January, shattering the record set just two months before. Chinese milk powder buyers may have stocked up in January ahead of the country’s lunar New Year celebrations, when business activity slows. But even if some of the purchases were anticipatory, these volumes imply nearly insatiable demand for WMP. As processors in New Zealand and elsewhere turn full fat milk into powder, there will be less cream available for butter churns.
China imported 75.3 million lbs. of skim milk powder (SMP) in January. This was slightly lower than the record-large purchases of December but 93% greater than January 2013 imports. The U.S. accounted for over 13% of the volume. China’s combined imports of SMP and WMP were 68% higher than the prior year. If Chinese milk production continues to slow this year, China could easily absorb the expected increase in milk production in the U.S., Europe and Oceania.

However, there are growing concerns about the health of the Chinese economy. A Bank of America-Merrill Lynch survey of investment fund managers found that nearly half believe the possibility of a “hard landing” in China is the biggest tail risk to the global economy. China is already suffering a liquidity crisis and the real estate boom there seems to be ending. The former could slow business investment, while the latter may restrict asset appreciation among the growing middle class. Economic pain in China could quickly translate into a decline in the flow of dairy products and other commodities to Southeast Asia. Furthermore, it seems presumptuous to assume that the Chinese milk production deficit will compound itself year after year. At the very least, dairy and other commodity markets that are increasingly dependent on import demand from a single source should be wary of amplified volatility.

According to USDA’s Dairy Market News, butter prices gained a little ground in Oceania over the past two weeks. However, the market was 2.5% lower in Europe. Milk powder prices were a little lower in both regions. But the milk powder markets remain near historic highs, and this prompted Fonterra to raise its forecasted milk payout yet again to a record $8.65 per kg of milk solids. This is up 35¢ from their previous estimate. Some dairy producers on New Zealand’s North Island have begun to complain about drought. But given such lofty milk prices, dairy producers in dry areas will likely provide supplemental feed as the season winds down.

Weekly dairy cow slaughter totaled 57,815 head, down 11.9% from the same week a year ago. Dairy margins are excellent and cumulative dairy cow slaughter is 9.1% lower than in the first seven weeks of 2013.

As noted above, investors are concerned about the impact that a Chinese slow-down might have on commodity markets, and murky evidence from China suggests that those concerns are well-founded. However, while traders have expressed these fears, they have hardly put their investment money where their mouth is. For now, a slowdown in Chinese imports is nothing more than a shimmering phantasm on the distant horizon, and one that is easily dismissed in light of booming Chinese demand for everything from almonds to zinc. Thus, commodity markets moved broadly higher on Thursday and Friday, spurred upward by a weakening U.S. dollar. The greenback slid after Federal Reserve Chairwoman Janet Yellen left room for the central bank to stay the course on easy monetary policy if the economy does not show further signs of strength.

Grain Markets
A rising tide lifts all boats, and grain and oilseed markets moved higher this week. Corn futures added a nickel. Ethanol and export demand remain strong, which may be supporting grain prices. Farmers are taking the
opportunity to sell some of their crop.

Soybean futures surged to new contract highs on Thursday. The March contract topped $14.50/bushel but then plunged, posting what chart-watchers call a downside reversal. This signaled the potential for further declines and the possibility of relief for dairy producers and other end users. Instead soybean futures rallied again on Friday. All told, soybean futures added 45¢ this week. U.S. soybean export commitments are simply too large. Tight domestic soybean supplies may slow the crush rate, which would reduce soybean meal supplies and prompt further strength in U.S. soybean meal prices.

Dry weather has limited crop yields in southern Brazil. Research group Safras & Mercado cut its forecast for Brazilian soybean production to 86.1 million metric tons (MT), down from its estimate of 91.8 million MT last month. Still, Brazilian soybean exports are expected to rise 7% from last year. There is no shortage of soybeans in South America. However, with Argentine farmers holding their crops as a hedge against inflation, those supplies are doing little to alleviate scarce inventories and high prices in the U.S.

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LATEST DAIRY CARES COLUMN POSTED ON OUR WEBSITE: (By Rob Vandenheuvel) The February 2014 Dairy Cares Report has been posted on our website:
This month’s column focuses on some of the efforts that have been – and continue to be – done to build consumer confidence in California and U.S. dairy products.

As noted in the column, much of that work is done in concert with the Center for Food Integrity (CFI), a “not-for-profit coalition whose members represent all segments of the food chain, including farmers and ranchers, universities, food processors, restaurants, retailers and food companies. CFI works to build trust and confidence in today’s food system by sharing accurate and balanced information while highlighting best practices that are ethically grounded, scientifically verified and economically viable.” Take a look at this month’s column to see more about CFI’s thoughts on how to continue building this consumer confidence.

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REMINDER: 2014 CDQAP “ENVIRONMENTAL STEWARDSHIP” CLASSES COMING UP: (By Rob Vandenheuvel) Many California dairies have already participated in past Environmental Stewardship classes hosted by the California Dairy Quality Assurance Program (CDQAP). But for those of you who haven’t, you’ll have another opportunity in the coming weeks when meetings are scheduled in Tulare and Fresno.

**Water Quality Classes**

*Thursday, March 27*

- Part One: 9 a.m. to 12 noon
- Part Two: 1 to 4 pm
- Southern California Edison Energy Education Center (formerly Edison AGTAC) 4175 South Laspina Street, Tulare, CA

**Air Quality Class**

*Thursday, April 3*

- 9:30 a.m. to 12:30 p.m.
- Fresno County Farm Bureau
  1274 W. Hedges Avenue, Fresno, CA

For any California dairy that has not already been “environmentally certified” by the CDQAP program, this is your only scheduled opportunity this year. The attendance to these classes, along with a followup on-site inspection of your dairy, is what is required to receive this certification.

Besides the benefit of being recognized as an environmentally responsible dairy operator, the certification also means a 50% reduction in your annual fees paid to the State Water Board for the next five years (which has
become a significant discount, as the State continually ramps up these annual fees). While the onsite inspection will cost you $550, you can see in the table below that with the ridiculous increases in recent years to the annual water quality fee, your dairy’s participation pays for itself many times over:

<table>
<thead>
<tr>
<th>Size of dairy (milking + dry)</th>
<th>Normal Annual Fee</th>
<th>Discounted Annual Fee for Certified Dairies</th>
<th>Five Year Value of Discount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 300</td>
<td>$747</td>
<td>$373</td>
<td>$1,867</td>
</tr>
<tr>
<td>300-699</td>
<td>$1,494</td>
<td>$747</td>
<td>$3,734</td>
</tr>
<tr>
<td>700-1,499</td>
<td>$2,988</td>
<td>$1,494</td>
<td>$7,471</td>
</tr>
<tr>
<td>1,500-2,999</td>
<td>$6,225</td>
<td>$3,113</td>
<td>$15,563</td>
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<tr>
<td>3,000 or more</td>
<td>$9,960</td>
<td>$4,980</td>
<td>$24,900</td>
</tr>
</tbody>
</table>

A flyer with more information on the upcoming classes can be found on our website at: [http://www.milkproducerscouncil.org/2014cdqap.pdf](http://www.milkproducerscouncil.org/2014cdqap.pdf). MPC members wishing to participate in this program should contact either myself at (909) 992-9529, Betsy Hunter at (661) 205-6721 or Kevin Abernathy at (209) 678-0666.

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**USDA REMINDS FARMERS THAT EQIP FUNDING IS AVAILABLE FOR DROUGHT RELIEF MEASURES: (By Kevin Abernathy)** USDA has made $25 million available through the EQIP program to assist in efforts to protect drought-stricken farm ground and help stretch our existing water supply.

According to their press release, USDA’s Natural Resources Conservation Services (NRCS) can: “*help farmers and ranchers understand the options for their particular water situation, soil type and production goals and develop a plan to get through this drought. Soil conservation practices for fallow land include cover crops, residue management, mulching and other complimentary practices. To help ranchers suffering from drought conditions, NRCS can offer practices such as livestock well development, piping, troughs, and fencing. For some ranchers, this may allow livestock to take advantage of available grass while protecting vulnerable ranch resources.*”

A preliminary signup deadline of March 3rd (next Monday) was announced, but farmers interested in taking advantage of this funding opportunity are encouraged to consult with their local NRCS office, even if you cannot make that March 3rd deadline. MPC members interested in this program should contact me at kevin@milkproducers.org.