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DATE: January 29, 2016 **PAGES: 4**
TO: Directors & Members **FROM: Rob Vandenheuvel, General Manager**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE		
Blocks	*N/C*	$1.4600
Barrels	*N/C*	$1.4300
Weekly Average, Cheddar Cheese		
Blocks	*- $.0175*	$1.4600
Barrels	*- $.0481*	$1.4300

CHICAGO AA BUTTER		
Weekly Change	*+$.0500*	$2.2200
Weekly Average	*+$.0512*	$2.1950
DRY WHEY		
Dairy Market News	w/e 01/29/16	$.2500
National Plants	w/e 01/23/16	$.2352

NON-FAT DRY MILK		
Week Ending 1/22 & 1/23		
Calif. Plants	$0.7960	9,971,724
Nat'l Plants	$0.7689	13,998,323
Prior Week Ending 1/15 & 1/16		
Calif. Plants	*$0.8054*	*5,831,541*
Nat'l Plants	*$0.7857*	*12,258,024*

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FRED DOUMA'S PRICE PROJECTIONS…

Jan 29 Final:	**Quota cwt. $15.15**	**Overbase cwt. $13.45**	**Cls. 4a cwt. $13.28**	**Cls. 4b cwt. $13.08**
Last Week:	**Quota cwt. $15.14**	**Overbase cwt. $13.44**	**Cls. 4a cwt. $13.25**	**Cls. 4b cwt. $13.08**

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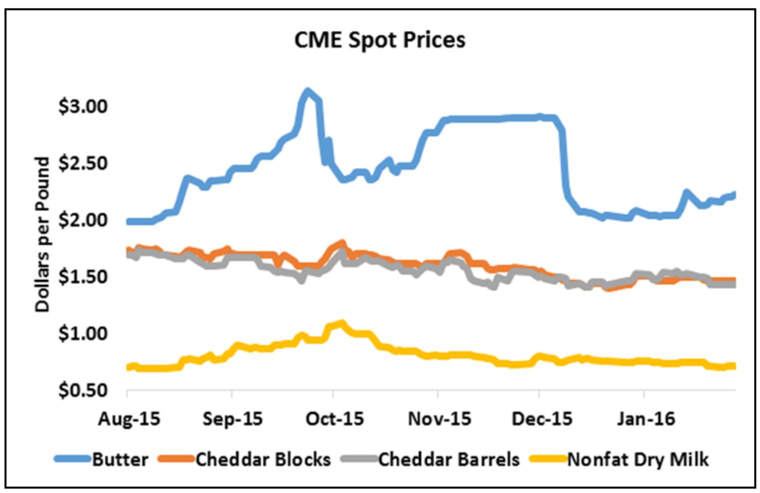
MARKET COMMENTARY: *(By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)*

Milk & Dairy Markets

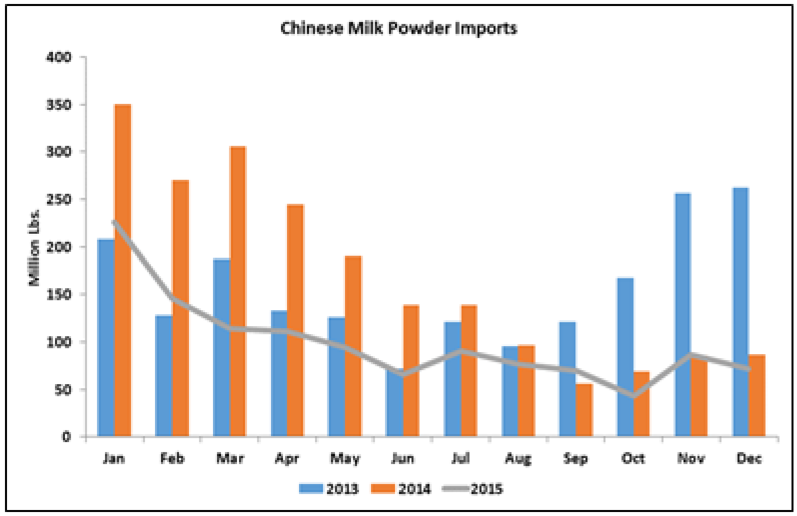
The CME spot cheese market was disconcertingly quiet this week with hardly a bid or offer. Cheddar blocks and barrels didn't budge; they closed Friday at $1.46 and $1.43, respectively. Nearby cheese futures climbed but deferred contracts retreated. Class III futures were similarly mixed, with gains in the low double digits in the first quarter and modest losses thereafter. Whey futures ascended.



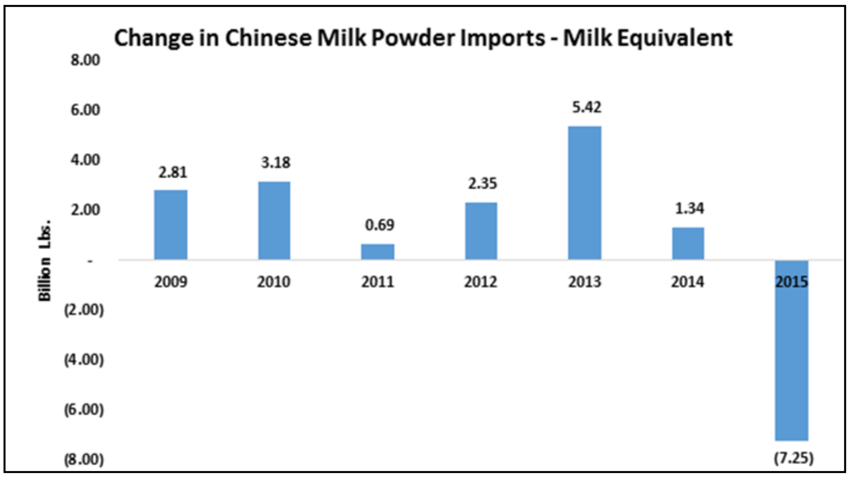
After a dizzying drop last week, it seems the spot butter market was due for a bounce. It climbed a nickel from last Friday and closed at $2.22, still a few cents below the recent spike high. The market managed to shrug off the big jump in butter inventories in December, as reported in last Friday's Cold Storage report, but butter buyers should be feeling less anxious about restocking ahead of the Easter holidays. The CME Group's new specifications for spot butter will take effect Monday, opening the exchange to a greater volume of deliverable butter. *Dairy Market News* reports, "Cream volumes are heavy throughout the country and are mostly clearing into butter churns."

Spot nonfat dry milk (NDM) retreated Monday but bounced Wednesday and Thursday. It finished at 71.75¢, up 0.75¢ from last Friday. NDM futures surged Wednesday, which was perplexing in a market that has long been plagued with heavy supplies and questionable demand prospects. It appears that the trade was leaning too far to the short side and there was a vacuum of ready sellers. But after Wednesday's correction the futures plunged both Thursday and Friday, putting them deep in the red for the week. A few Class IV contracts in the first half finished higher than last week, but second-half contracts dropped.

Chinese imports of skim milk powder (SMP) improved in December to 34.2 million pounds, up 5% from the prior year and nearly 30% more than November on a daily average basis. Chinese whole milk powder (WMP) imports remain depressed. For the year, combined imports of SMP and WMP totaled 1.2 billion pounds, down 41.2% from the record-breaking volumes of 2014. On a milk equivalent basis, "the decline in milk powder exports to China resulted in 7.25 billion pounds of milk either having to find a different market or different product class," according to the *Daily Dairy Report*.

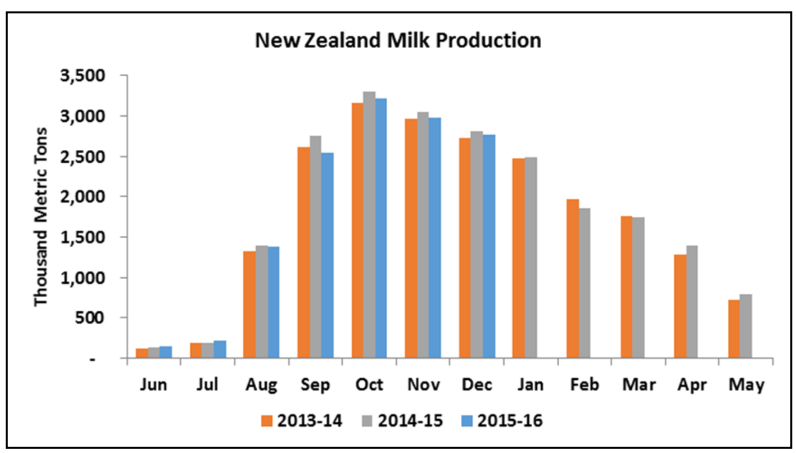


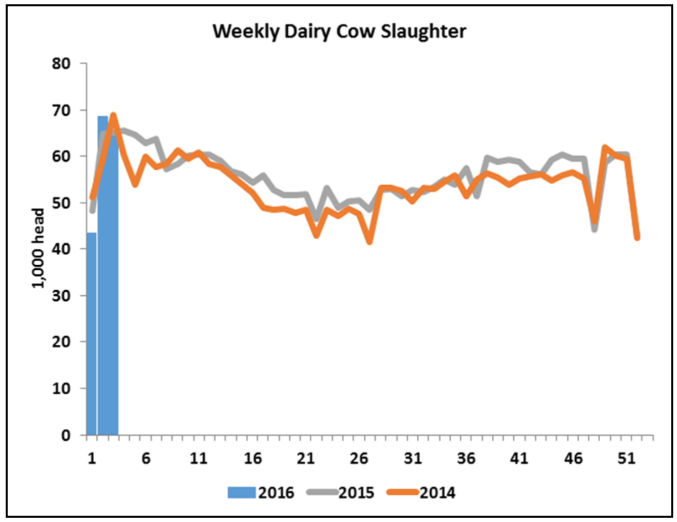
When Chinese milk powder imports boomed in 2013 and 2014, the market misinterpreted growth in imports as increased consumer demand for dairy products. Consumption was indeed on the rise, but its growth was exaggerated by a Chinese milk production deficit and stockpiling on a massive scale. Today, the milk powder market is in the doldrums, and the trade may be making the opposite mistake in assuming that lower imports can only signal waning Chinese demand for dairy products. There are reasons to be concerned about Chinese demand, as evidenced by the global commodity market downturn. But as merchants draw on stockpiles and improved domestic supplies, they may require fewer imports for a time even if consumer demand is growing. If Chinese milk production suffers a setback or stockpiles diminish further, the trade giant could regain its appetite for foreign milk powder. Chinese imports of cheese and whey are, in fact, moving a little higher.



But for now the industry must still contend with the hangover caused by China's aggressive purchases and dairy producers' over-exuberant response. Following the lead of its competitors in New Zealand, Fonterra lowered its pay-price forecast from NZ$4.60/kg of milk solids to NZ$4.15. After dividends and retentions this equates to around $9.20/cwt. at the current exchange rate.

In its press release, Fonterra recapped the fundamentals behind the current supply and demand imbalance. "Key factors driving dairy demand are declining international oil prices which have weakened the spending power of countries reliant on oil revenues, economic uncertainty in developing economies and a slow recovery of dairy imports into China. In addition, the Russian ban on European Union dairy imports continues to push more product on to the world market. Although New Zealand farmers have responded to lower global prices by reducing supply, that has yet to happen in other regions, including Europe, where milk volumes have continued to increase." Milk production in New Zealand slipped to 6.1 billion pounds in December, down 1.6% from a year ago. This put season-to-date production down 2.8% from the 2014-15 season, a much smaller deficit than many had expected just a few months ago.





For the week ending January 16, dairy cow slaughter totaled 65,528 head, up 0.5% from a year ago. After three weeks, the cull rate is 3.4% ahead of the 2015 pace. Cow slaughter remains elevated in Region 6 as Texas and New Mexico dairy producers and their cows are still feeling the impact of Winter Storm Goliath.

Grain Markets

The corn and soybean markets both finished higher this week. March corn settled at $3.72 per bushel, up 1.75¢. Soybeans climbed 5.75¢ to $8.8225. The grain complex took a big hit Thursday after China cancelled some soybean import contracts and as the forecast for rains in Argentina improved. However, the markets rebounded Friday, perhaps with the help of a surging stock market. In the long run, the global grain and oilseed markets are well supplied. It will take a severe weather issue to push the markets significantly higher.

In the future the grain markets may have to adjust to some major policy shifts in China. The Central Committee and State Council announced Wednesday that the government intends to allow the market to influence prices. Currently, in order to encourage domestic production, the government sets a price drastically higher than the global market at which it will buy corn from farmers. It also has a vast network of subsidies for farmers and end users as well as restrictions on imports. After years of overpriced purchases, USDA estimates Chinese corn stocks at 113.5 million metric tons, equal to 54% of global corn inventories.

It is unclear exactly how China will go about shifting to a more market-oriented corn policy. They will likely do so very slowly, as Beijing is extremely wary of civil unrest. A drastic drop in corn prices is sure to be unpopular in rural China. But if China does successfully make this shift, it could ripple through the grain world. The most immediate consequence for U.S. farmers is likely to be a decline in exports of corn substitutes like DDGs, sorghum, and barley, which have been heading to China in large volumes.

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ONE FULL YEAR INTO THE MARGIN PROTECTION PROGRAM: *(By Rob Vandenheuvel)* Well, the first full year of the Margin Protection Program is in the books. Today, USDA published the final December 2015 national milk and feed price calculations for determining the "milk-price-over-feed-cost" margin that drives the Margin Protection Program (MPP). As you probably expected, the margin for the final period (November-December) were well above the levels that would have triggered any sort of indemnity payment for enrolled dairy farms.

As a reminder, the MPP is a USDA-run program that allows dairies to enroll at various "milk-price-over-feed-costs" margin levels between $4.00/cwt and $8.00/cwt. Every two months, the national average "margin" for those months is announced, and dairies that enrolled at a margin level *above* the announced margin are entitled to a payment for the difference. The lowest level available for enrollment – $4.00/cwt – does not have a premium *(although it does carry a $100 annual administrative fee)*, while the levels above that basic protection have an escalating premium associated with enrollment.

Below is a table showing the final bi-monthly prices that drove the MPP for 2015:

	National "All Milk Price"	**National Est. Feed Cost**	**"Margin"**
January-February 2015	$17.20	$9.20	$8.00
March-April 2015	$16.55	$9.05	$7.50
May-June 2015	$16.80	$8.80	$8.00
July-August 2015	$16.65	$8.95	$7.70
September-October 2015	$17.60	$8.52	$9.08
November-December 2015	$17.70	$8.14	$9.56

According to USDA figures, out of the 1,112 California dairies that enrolled in the MPP in 2015, none of them enrolled at the $8.00/cwt maximum level. *(That makes sense, as California's larger dairy facilities would face a stiff premium of $1.36/cwt on most of their milk enrolled at that maximum level.)* So what that means is that no California dairies received any indemnity payment from the MPP in 2015. And in fact, even dairies around the country that did enroll in the $8.00/cwt maximum level and did collect indemnity payments collected less than they had paid in as premiums, whether their dairy is large or small.

Now it's important to note here that in general, this alone is not a bad thing. After all, how many of us buy term life insurance hoping it will expire without ever paying a dime? The questions here lies in what the program is intended to protect dairies against. When the program was being debated as part of the Farm Bill, it was clear at the time that it was being crafted to provide as much financial assistance as possible (under the Congressional budget restrictions) to enrolled dairies of all sizes during "catastrophic" time periods such as 2009 or 2012. So how did 2015 compare to those time periods?

	Avg. U.S. "All-Milk Price"	**Avg. Est. Nat'l Feed Cost**	**"Margin"**	**Lowest 2-Month "Margin"**
2009	$12.83	$8.25	$4.58	$2.49
2012	$18.53	$13.21	$5.32	$2.88
2015	$17.08	$8.78	$8.30	$7.50

As you can see, while 2015 was a challenging year, particularly for California dairy farmers (who saw average prices in all three of these years significantly below the U.S. All-Milk Price…thank you CDFA for the "California Discount"!), it simply didn't reach the "catastrophic" levels that we saw in 2009 (low milk price) and 2012 (high feed costs) that would have triggered any real payments under the MPP. And we can certainly be thankful for that! Had our milk prices mimicked the announced prices being paid for milk in other parts of the world *(such as New Zealand, with the $9.20/cwt forecast mentioned in Sarina's report above!)*, we would have had payments made under the MPP, but your overall dairy operation would have been MUCH worse off financially.

So looking forward in the next several months, what can we expect with regard to the MPP? Let's assume for this discussion that the national average feed prices maintain their current levels, at around $8.00-$8.50/cwt. So what do we expect the U.S. All-Milk Price to be in the coming months?

The Federal Order Class III price is a decent (although far from perfect) indicator for the U.S. All-Milk Price, given how much of the country's milk is based on that formula (for either Class III or Class I products). Over the past several years, the announced U.S. All-Milk Price has generally been $1-2/cwt above the announced Federal Order Class III price for that month (again, not a perfect comparison, but more of a back-of-the-envelope estimate). So looking out in to the next several months, the Class III futures market indicates that traders expect Class III prices to be at-or-below $14/cwt for the next four months. If that occurs, we can reasonably expect the U.S. All-Milk Price to be announced in the $15-16/cwt range in that time frame. Comparing that to a $8.00-$8.50/cwt national average feed cost, we'd be looking at announced "milk-price-over-feed-cost" margins of $6.50-$8.00/cwt.

Will this happen? Only time will tell. In the meantime, while it is absolutely wise to take steps to protect your dairy from catastrophic milk price collapses or skyrocketing feed costs, we should be hopeful that we go through 2016 without the program ever paying out a dime. A stronger milk check beats a MPP indemnity payment every time.