



Milk Producers Council

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DATE: January 3, 2014
TO: Directors & Members

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FROM: Rob Vandenheuvel, General Manager

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE

Blocks +\$.0425 \$2.0425
Barrels - \$.0500 \$1.9200

Weekly Average, Cheddar Cheese

Blocks +\$.0144 \$2.0144
Barrels - \$.0850 \$1.8825

CHICAGO AA BUTTER

Weekly Change +\$.0200 \$1.5700
Weekly Average - \$.0387 \$1.5413

DRY WHEY

Dairy Market News w/e 01/03/14 \$5.888
National Plants w/e 12/28/13 \$5.716

NON-FAT DRY MILK

Week Ending 12/27 & 12/28

Calif. Plants \$1.9436 4,518,409
Nat'l Plants \$1.9785 7,709,258

Prior Week Ending 12/20 & 12/21

Calif. Plants \$1.9321 7,816,839
Nat'l Plants \$1.9625 17,171,041

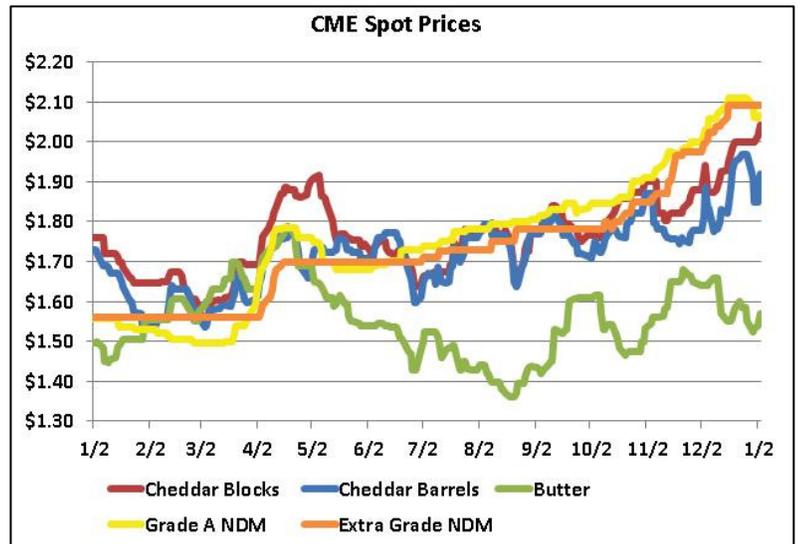
FRED DOUMA'S PRICE PROJECTIONS...

Jan 3 Est: Quota cwt. \$21.64 Overbase cwt. \$19.95 Cls. 4a cwt. \$21.21 Cls. 4b cwt. \$19.13
Dec '13 Final: Quota cwt. \$20.99 Overbase cwt. \$19.29 Cls. 4a cwt. \$21.16 Cls. 4b cwt. \$18.03

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

Milk & Dairy Markets

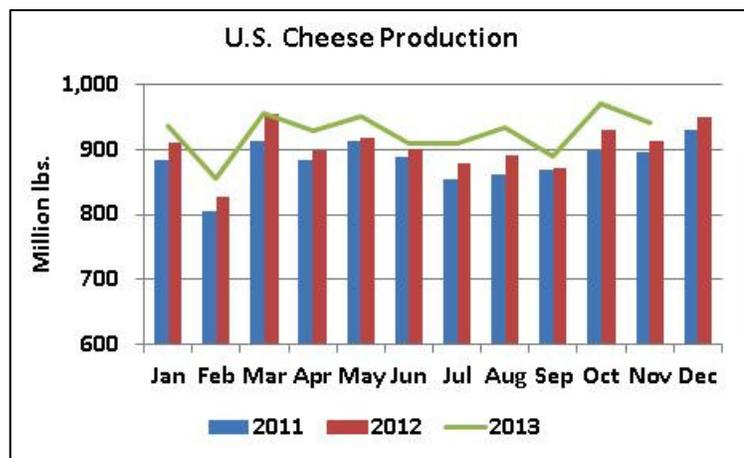
What goes up must come down, but, as the Class III market demonstrated this week, it doesn't have to stay there. CME spot Cheddar barrels lost 6¢ on Monday and another 6¢ on Tuesday, ending the year at \$1.85, 12¢ below the 2013 highs established just a few sessions before. Blocks managed to hold steady at \$2.00/lb., while Class III futures followed the barrel market lower. But the new year brought new bids, and barrels regained 7¢ on Friday. Blocks rallied both Thursday and Friday, and closed the week 4.25¢ higher than they began it. January through June Class III futures posted double digit gains, and the February contract added nearly a dollar this week.



Grade A nonfat dry milk (NDM) also fell on Monday and Tuesday, but managed tepid gains on Friday. Grade A NDM closed at \$2.0675/lb., down 4.25¢ this week. Extra Grade NDM held steady at \$2.09, putting it above Grade A for the first time since June. Volatility has robbed the milk powder market of its momentum, and if there are further rallies, they will no longer carry an air of inevitability. Spot butter lost 2.75¢ Monday but battled back throughout the week and closed at \$1.57, up a couple cents from last Friday. Class IV futures were little changed compared to last week, but most contracts settled lower.

The California Department of Food and Agriculture announced the December 4a milk price at \$21.16/cwt., up

53¢ from November. The 4b price gained 73¢ at \$18.03. This compares to the December Class III price of \$18.95, which was 12¢ higher than November. For the year, Class III milk averaged \$17.99, up 55¢ from 2012 although 38¢ shy of record high prices in 2011. At \$21.54, December Class IV milk was \$1.02 higher than in November. Class IV milk eked out a record in 2013, averaging \$19.05 and besting the 2011 average of \$19.04. California 4a milk averaged \$18.85 in 2013, up \$3.22 from 2012.



The eggnog and cheese platters have been put away; holiday demand is behind us. Hopefully the frigid temperatures and icy roads that plague much of the country will empty the milk case as consumers stock up and hunker down. Seasonal demand has recently helped to support the cheese market. Consumption was reportedly sufficient but not impressive given the time of year.

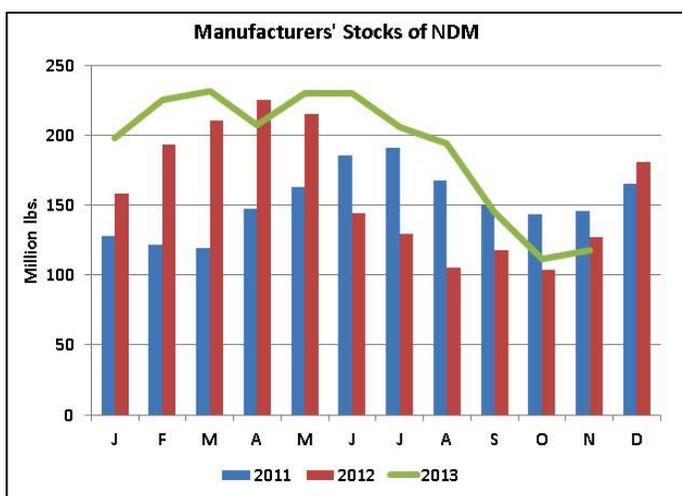
Cheese production has also been merely adequate. According to USDA's Dairy Products report, November cheese production totaled 940.7 million lbs., up 2.9% from last year but only 0.1% higher

than October on a daily average basis. Given tepid growth in Midwest milk output and cheese production, cheese prices could find support even at historically high prices. But that depends on post-holiday demand. While the Dairy Products report did nothing to hamper the strength in cheese prices, the market remains cautious and uncertain.

Cheese makers are eschewing Cheddar in favor of mozzarella and other foreign varieties. Cheddar production fell 3.4% from a year ago while mozzarella production was up 7.6%. This helps to explain why fresh Cheddar blocks are reportedly scarce.

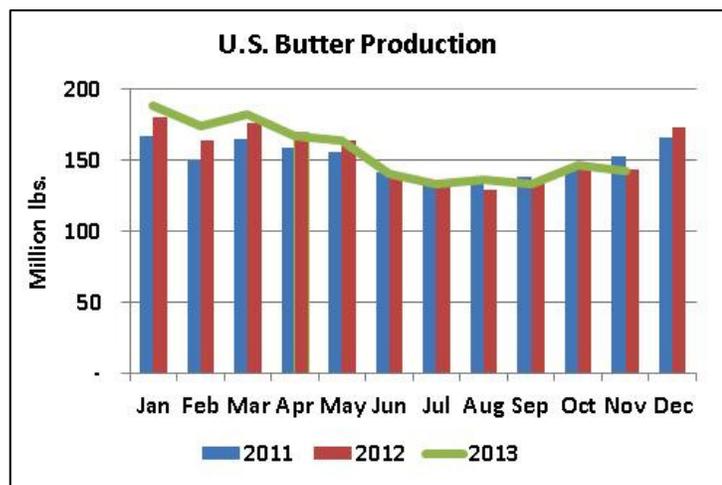
Combined production of skim milk powder (SMP) and NDM fell 2.5% below that of November 2012. But at 156.5 million lbs., NDM/SMP production was 9.1% greater than October, in line with seasonal increases in milk powder production late in the year.

Manufacturers' stocks of NDM grew 6.1% in November, after declining sharply in the preceding four months. Still, inventories fell 6.8% below year-ago levels. According to *Dairy Market News*, some NDM manufacturers



are struggling to fulfill contracted orders on time, and stocks remain tight.

November butter production totaled 142.8 million lbs., up 0.9% from October on a daily average basis but slightly below November 2012. Butter demand remains firm, and those with product to export are able to command a premium.



In the week ending December 21, dairy producers culled 61,514 cows. This was down 8.9% from the same week in 2012 when liquidations encouraged heavy slaughter. With one week to go, dairy cow slaughter is 0.5% greater than in 2012.

Grain Markets

Brazilian farmers have started harvesting their earliest soybeans, and China continues to reject U.S. DDG shipments. With that, the soybean and soybean meal markets have finally capitulated, offering some relief from painfully high oilseed prices. January soybeans lost more than 40¢ this week. The DDG issue is likely the primary cause of the break in prices. Exporters are no longer clamoring for DDGs, and prices at the port of New Orleans dropped precipitously. Prices are starting to decline in the interior, although inconsistently. USDA reported Illinois DDG prices from \$180 to \$200 per ton, down from \$225 last week. But prices have not yet dropped in Iowa or points west according to USDA. However, most feed vendors are banking on a decline and willing to offer contracted DDGs at notably lower prices.

There is no shortage of moisture in northern Brazil, and rains have improved in southern Brazil and northern Argentina over the past couple weeks. It is still dry in central and southern Argentina, but excellent conditions in the rest of South America will help to offset any yield losses there.

Corn futures lost a few cents this week. Corn exports fell to a marketing year low as China's stance against U.S. corn is beginning to take effect. The corn market appears quite comfortable within its recent trading range.

A NEW YEAR...SO WHAT'S ON THE AGENDA? *(By Rob Vandenheuvel)* 2013 is now officially in the books, and we have embarked on 2014. There seems to be a cautious optimism in the air, with dairy markets at historically strong levels and prices for some of the primary feed commodities – particularly corn – down significantly from recent highs. Of course, in an industry with markets as volatile as the dairy industry, we've seen this before, but for some reason, this time feels different. After five years of mostly struggles in the industry – particularly here in California – it seems that we are on the verge of “turning the page” and setting on a better course. What happens in the coming days and months will determine whether that actually happens.

Reports indicate that a Farm Bill is close to being completed, perhaps even this month. This has been several years in the making, but it appears that we are on the verge of fundamentally reforming our dairy safety net programs. Of course, it doesn't solve every problem our industry faces, but it solves one of the biggest: providing dairy farmers – both large and small – with a meaningful option to protect against prolonged market downturns. And if Congress can read through the propaganda constantly churned out by nation's processors, who's main goal in this debate has been to keep milk as cheap as possible, we may have a stand-by Market Stabilization Program that helps shorten those market downturns in the first place, which is ultimately the best outcome for our industry.

A Federal Milk Market Order in California appears to be moving forward at a rapid pace. Of course, it's a lengthy process that will certainly not be completed in 2014, but nonetheless, after trying every method possible to get the much needed changes to the California system – whether through administrative hearings, legislation, or even a lawsuit – California dairy families appear to be very focused on going down this path to a Federal Order. Producers certainly have questions about this process, many of those focused on how it will handle our State quota program or how the pooling rules will be different. While we don't know all the answers yet, they are certainly all solvable issues, and I expect that the coming months will bring a lot of clarity to this process.

While those two items appear to be on the fast track in the near term, there are other issues that MPC and others will certainly be involved with as well.

It looks like Congress is planning to take a serious look at the nation's corn-based ethanol policies. This is an issue that's been brewing for years, and with a bipartisan Senate bill introduced late last year and a comparable House bill planned soon, the issue is poised for a serious discussion in 2014. Of course, given the impact this policy has had on feed commodity process, MPC and many others have been involved in this debate for years. But more recently, the ethanol policies have grown to a point where it is actually mandating a volume of ethanol

that isn't even feasible to blend with our nation's fuel supply, given current market conditions. We saw preliminary action by EPA late last year to start correcting this problem, but it's anticipated that Congress will debate/discuss more fundamental changes in the coming months.

Immigration, as in years past, continues to be on Congress's agenda as well. Last year, we saw significant progress, with the Senate approving a bold, comprehensive plan that includes much needed changes for dairy and other agriculture. However, that effort has been stalled in the House of Representatives, where there seems to be political problems with taking up immigration in a comprehensive manner. They have been saying they prefer a piecemeal approach, dealing with the major immigration issues one-by-one. Given that it's an election year, it's tough to know whether a year from now we'll have seen any progress, but this is certainly an important issue for dairy farmers around the country, and as such is a major priority for us all.

Finally, there is some increasing chatter about tax reform in Congress. As I wrote above, given that it's an election year, I'm not sure how realistic the prospects are, and President Obama recently nominated the chief tax policy writer in the Senate – Sen. Max Baucus from Montana – to serve as the U.S. Ambassador to China. However, one issue that has come up as part of a potential tax reform package is the removal of the “cash-basis accounting” option for the largest farmers. As you all know, cash-basis accounting is a key component of the tax-planning methods used by U.S. farmers, so dairy and other agriculture interests will obviously be closely watching this debate.

While the items above would certainly keep any industry busy all year, we know that this is not an all-inclusive list. Whether it's a California bill aimed at micro-managing the way farmers care for their animals, or helping to get ready for the implementation of Obamacare (at least the implementation on businesses; I've already been forced to get my individual Obamacare plan), there is never a dull moment in this industry. Let's hope that 2014 brings continues strong dairy markets and at least the first two items above. **It should go without saying that it's a whole lot easier to tackle the other items on the agenda if we've at least got the tools to help your dairy maintain profitability long-term.** And of course without sustained profitability, the other issues are moot anyway.

*Editor's Note: Last week, we incorrectly identified one of our valued associate members as Wiechelman & Associates. Their current name is **Wiechelman Accountancy Corp.** We apologize for the error, and greatly appreciate their continued support of Milk Producers Council and the dairy families we represent.*