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DATE: December 11, 2015 **PAGES: 4**
TO: Directors & Members **FROM: Rob Vandenheuvel, General Manager**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE		
Blocks	*- $.0725*	$1.4450
Barrels	*- $.0625*	$1.4225
Weekly Average, Cheddar Cheese		
Blocks	*- $.0680*	$1.4765
Barrels	*- $.0335*	$1.4760

CHICAGO AA BUTTER		
Weekly Change	*- $.7025*	$2.2000
Weekly Average	*- $.2965*	$2.6060
DRY WHEY		
Dairy Market News	w/e 12/11/15	$.2375
National Plants	w/e 12/05/15	$.2354

NON-FAT DRY MILK		
Week Ending 12/4 & 12/5		
Calif. Plants	$0.7488	6,446,214
Nat'l Plants	$0.7785	14,813,834
Prior Week Ending 11/27 & 11/28		
Calif. Plants	*$0.7703*	*4,870,536*
Nat'l Plants	*$0.7886*	*10,207,170*

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FRED DOUMA'S PRICE PROJECTIONS…

Dec 11 Est:	**Quota cwt. $15.71**	**Overbase cwt. $14.02**	**Cls. 4a cwt. $14.63**	**Cls. 4b cwt. $13.03**
Last Week:	**Quota cwt. $16.59**	**Overbase cwt. $14.90**	**Cls. 4a cwt. $16.73**	**Cls. 4b cwt. $13.50**

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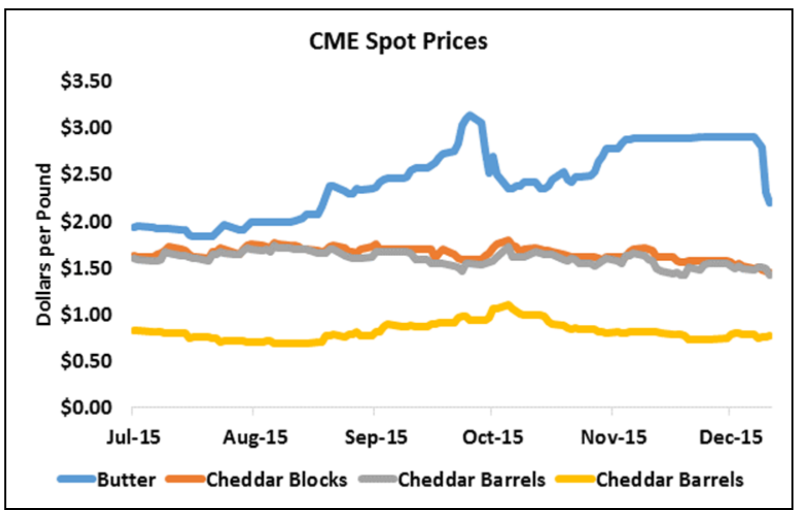
MARKET COMMENTARY: *(By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)*

Milk & Dairy Markets

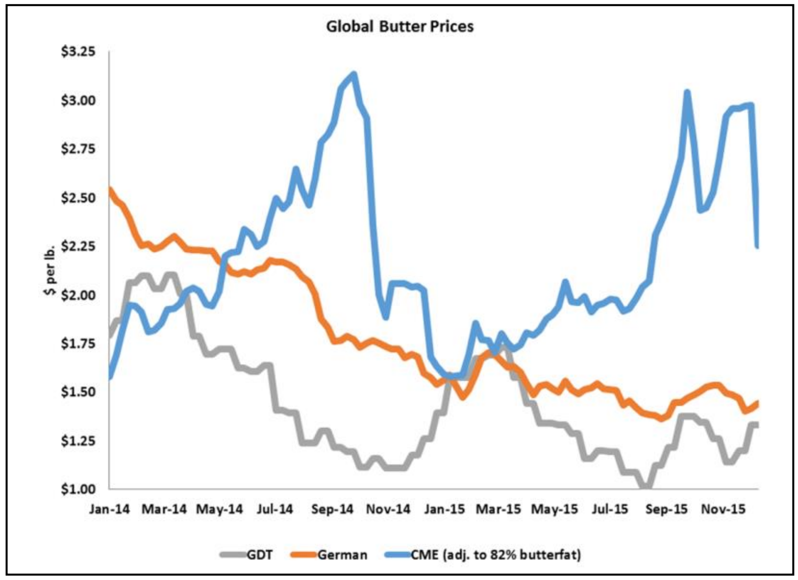
After more than a month of strained silence, the CME spot butter market finally imploded. The collapse was widely expected but nonetheless stunning to behold. Spot butter slipped 0.25¢ Monday; it fell another 6¢ Tuesday and lost a nickel on Wednesday. But this was just the warm-up. On Thursday butter plummeted 49¢, the largest single-day move ever. After another 10¢ drop today, spot butter closed at $2.20/lb.



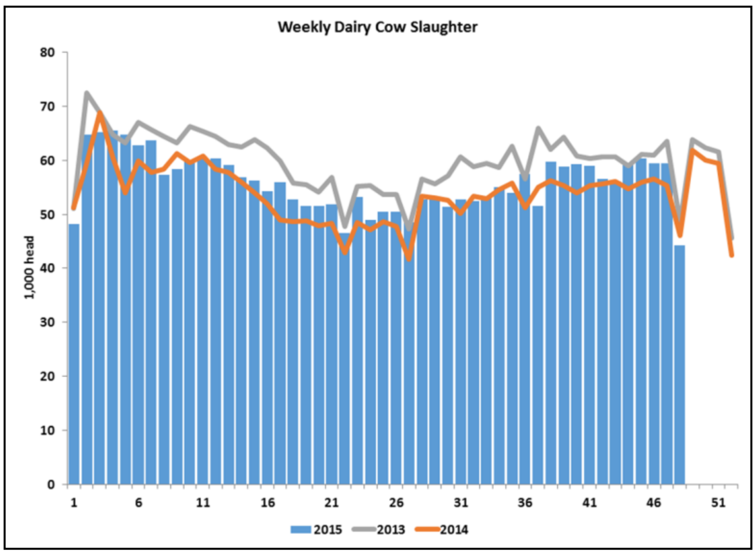
Even after this week's crash, spot butter is still the most expensive in the world, trading at an 80¢ to 90¢ premium to product from Europe and Oceania after adjusting for butterfat. Futures traders clearly expect further declines. The January contract settled at $1.98 today, and February butter closed at $1.91. 2016 futures have been pricing in a correction for some time and have lagged the spot market considerably. As such, they too moved lower this week, but their losses were miniscule compared to the 70.25¢ breakdown in spot butter.

Milk powder prices also retreated. Spot nonfat dry milk (NDM) closed at 77.25¢, down 1.5¢ from last Friday despite a late-week rebound. Most Class IV contracts lost between 20 and 40¢. The January and February contracts slipped back below $14.00.

The week-to-week declines in cheese prices were not nearly as dramatic as the action in the spot butter market, but they were perhaps more disappointing. It is one thing to fall from proud heights; it is quite another to drop from the depths. CME spot Cheddar blocks fell 7.25¢ to $1.445, a low not seen since January 2011. Spot Cheddar blocks dropped 6.25¢ to $1.4225. With little succor from the whey market, Class III futures slumped. The January contract dropped 58¢, settling at $13.70. January through August contracts scored new life-of-contract lows.

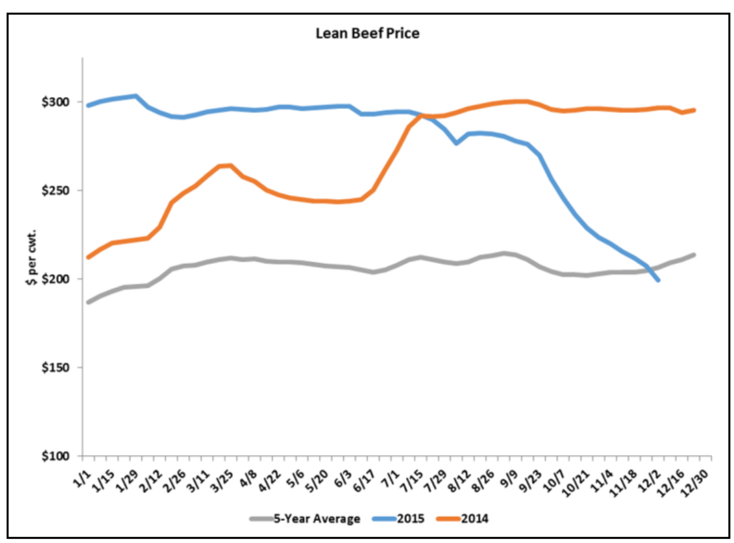


The holiday hangover hit the dairy markets hard this week. But there is some reason to hope. If nothing else, a bounce is likely after such a steep drop. That is not to say that the markets will regain all that they have lost. However, in the short run the market appears oversold. Holiday demand has run its course, but the American consumer still has a hearty appetite for dairy. Robust domestic demand has supported the U.S. dairy market in the face of a global dairy downturn and a formidable currency. It is likely to continue to undergird prices, albeit at much lower levels than those that prevailed last year. Finally, the California milk production deficit will eventually put a floor under the butter price. The 9% drop in Golden State butter output – not to mention the 3.9% drop in NDM production – in October should not be forgotten and will perhaps be repeated.



Most analysts are calling for the dairy market to truly recover in the second half of next year. The timing will depend on how quickly dairy producers in Europe and the Midwest react to lower milk prices. Margin pain has been pronounced enough to warrant a slowdown in Oceania and in the West for some time now. But in Europe dairy producers with decades of pent-up equity and entrepreneurism will not be deterred by a few months in the red. In the Midwest, milk checks have largely been adequate to cover modest feed costs, although basis disparities have stung producers in some areas. Things could get uglier this spring, as a heavy flush is likely to merit discounts against already low cheese prices.

For the week ending November 28, which included Thanksgiving, dairy cow slaughter totaled 44,264 head. For the year-to-date, dairy cow slaughter is up 4% from the 2014 pace.



The dairy markets were not alone in their rout this week. Commodities in general suffered, and the livestock markets were particularly wretched. Live cattle futures weathered rampant volatility and multi-year lows. Although the beef herd is only slightly larger than it was a year ago, weights are way up, imports have surged and exports are scarce. Of particular concern to dairy producers hoping to move mounds of ground beef: cheap pork and poultry are abundant. But here too there is hope. The cattle markets are likely near a bottom. There is a strong seasonal tendency for a significant rally from the lows at this time of year. Industry losses are heavy, and carcass weights are expected to wane soon. A bounce is probable, but in light of the steep losses of the past few months, it is likely to appear meager.

Grain Markets

The crop markets moved sharply lower on Monday and never fully regained their footing. March corn settled at \$3.7525 per bushel, down 6.25¢ on the week. January soybeans closed at \$8.7075, down 35.25¢.

USDA's monthly update to its World Agricultural Supply and Demand Estimates was benign. The agency made no changes whatsoever to its wheat and soybean balance sheets. USDA raised its estimate of corn used for ethanol and lowered its corn export projection, resulting in a 25-million-bushel net increase to ending stocks compared to last month. Global corn inventories remain at all-time highs.

The weather in South America has been generally favorable and the forecast holds regular rains. It's too soon to begin raising crop production estimates meaningfully, but the market has been willing to erase some of the weather risk premium. Moving forward, rallies in the crop markets will be limited due to the strong dollar and abundant competing crops in Argentina and Brazil.

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A BRIEF GLIMPSE INTO THE PROCESSOR PERSPECTIVE ON THE CA-FMMO HEARING: *(By Rob Vandenheuvel)* As regular readers of this newsletter already know, we've published numerous articles on the California-Federal Milk Marketing Order (CA-FMMO) hearing that adjourned last month. Our recent articles focused on the strong case made by the three major California cooperatives (CDI, DFA and LOL) that: (1) a CA-FMMO is absolutely needed; and (2) the cooperative/producer-supported proposal is the best option for our industry.

However, as you know, the Dairy Institute of California (DIC) – on behalf of the California dairy product manufacturers they represent – has also been a very active participant in the process. Their main arguments *(paraphrased by me)* have been that: (1) no CA-FMMO is needed, as California is already experiencing "orderly" milk marketing from the State Order run by the California Department of Food and Agriculture (CDFA); and (2) if USDA determines a CA-FMMO is needed, they propose a very different order, with steeply discounted minimum milk prices, the destruction of California's quota program, and very flexible pooling rules that would allow their manufacturers to cherry pick when they want to participate in the system.

So how does the DIC feel about how the hearing went? Following the conclusion of the hearing, the DIC published a press release, which you can find on their website at: http://www.dairyinstitute.org/wp-content/uploads/2015/11/Dairy-Institute-NR-111915.pdf. While you can read the full release there for yourself, there are a couple quotes from their Executive Director Rachel Kaldor that I wanted to highlight:

> *"Producer representatives have continued to maintain that prices they receive for their milk here in California are not the same as prices received in the upper Midwest…Dairy Institute members, as well as other expert witnesses, provided solid facts as to the differences in industry structure, competition for milk, and distance from markets that make a simple price comparison inaccurate."*
>
> *"California dairy cannot remain a zero sum game, where for one side to win the other side must lose. California dairy producers need to understand how important the entire dairy supply chain is to all industry stakeholders. We have to keep and build markets, and producers and processors have to build partnerships so that everyone can be on the winning side. The future of our industry depends on it."*

I realize and can appreciate that producers and processors come at this issue from very different perspectives. Producers are sellers of milk, processors are buyers. Milk prices represent a producer's primary income, while they represent a processor's largest input cost. So for the first quote above, I can understand why our processor colleagues would advocate for a lower milk price, and use whatever evidence they feel bolsters their argument.

In this case, they point out that there are different market dynamics that exist in the upper Midwest that may drive higher milk prices.

California producers would agree with this. There absolutely are different market dynamics throughout the country, and ultimate prices that plants pay for the milk they need differs from region to region and even plant to plant. However, in the context of this hearing, producers were ***not*** asking USDA to set the same ultimate milk prices as the upper Midwest, but rather set our base minimum price at the same level it is in **ALL TEN** of the current Federal Orders, which includes not only the upper Midwest, but Arizona, Oregon and Washington as well – all much closer to California than the upper Midwest. From that base price, producers fully understand that premiums will drive ultimate milk prices higher in some regions than others.

As for the second quote referencing a *"zero sum game,"* this is once again an argument that on its face sounds very logical and something producers could agree with. However, when you dig down further, your find that **this sound bite is really an attempt to distract from what the DIC is actually advocating**. Producers would agree that the best outcome is for both sides to work together and build markets that support profits for both producers and processors. **However, what the DIC put forth in their proposal is a system that hardwires their access to the lowest-cost milk in the country.** Period. End of story. Under their proposal, their manufacturers would buy their milk at a steep regulated discount *(more than $500 million in discounts in 2014, according to testimony during the hearing),* presumably allowing them to "keep and build markets" as their press release says. And producers would just have to *hope* that the manufacturers are so successful that they're willing to make us "winners" and share in the wealth under their system as well?

Of course, this fundamentally ignores the basic reason that government is involved in milk pricing in the first place. Our industry has made many developments over the years, but at its core, we are still an industry with dairy farmers that produce a highly perishable commodity product 365 days a year, having to sell to a group of buyers who don't have to buy every day, and don't have to buy from any particular dairy farmer. That built-in disparity in negotiating power is why the government – whether at the Federal or State levels – is involved as a "referee" in setting regulated milk prices. **Our State's manufacturers have just apparently gotten used to a referee in California (CDFA) that sees no problem with given them a steep discount in the milk they need to buy.**

Finally, I can't close out this article without commenting briefly on the statement in the release that, *"California dairy producers need to understand how important the entire dairy supply chain is to all industry stakeholders."* If I'm reading this right, the point the DIC is apparently trying to make is that one of our basic problems is that dairy farmers just don't understand the plight of the California dairy manufacturer and fail to appreciate the importance of the "entire dairy supply chain."

I have to admit that my first reaction when reading that line was disgust. After all the financial devastation in California we've experienced at the producer level over the past several years, largely due to the arbitrary discounting of our State's regulated milk price, it's pretty disgusting and even insulting to read a comment from anyone trying to tell California producers that this is really just a lack of understanding by dairy farmers.

However, with a calmer head, let me just set the record straight. Our dairy farmers absolutely appreciate all the business relationships that result in turning our raw milk into delicious finished dairy products on the tables of families all over the world. However, if the cost of those business relationships is chronically selling our raw milk for less than the cost of producing it, and at steep discounts to what other dairies around the country are able to sell the same quality milk for, producers will not stand by and allow that to continue unchecked.

To put it even more bluntly: if your manufacturing business only works as long as you can buy the cheapest milk in the country, regardless of whether the dairy farmer selling you that milk can even make a profit, you should have no place in this business. And no level of "understanding" in the world can hide that economic reality.