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The Power of Crude

The domestic and global dairy markets have recovered from the extreme price drops of 2009 but appear to have topped out as we enter the new decade. Despite a decrease in dairy product supply, an overriding economic slowdown in the United States is expected to keep dairy product prices from reaching the peaks of 2007 and 2008.

On the global front, lower-than-expected milk production out of Australia and New Zealand resulted in higher dairy product prices during the second half of 2009. Australia's milk production is expected to decline about 5% compared with the 2008-09 production season while New Zealand's output is anticipated to increase less than 1.5%, about half of what was forecast earlier. In

Europe, milk production is mixed. In Germany, a country that accounts for 19% of the European Union's total production, milk receipts are reportedly running 2% ahead of last year, but other European countries are reporting lower milk production.

While the level of European milk production is important, it is overshadowed by large government stocks of butter and skim milk powder. Current stock levels of butter and skim milk powder in Intervention are 76,449 metric tons and 267,458 metric tons, respectively. Indications out of the European Union are that stocks will not be released until May 2010. Most likely the stocks will be released as part of a public aid package, similar to the release of government-owned stocks in the United States.

U.S. milk producers have posted year-over-year declines in monthly milk production since August 2009. In November, production was down 1.0% vs. the prior year, driven by a 2.6% decrease in the U.S. dairy herd that was not offset by a 1.6% increase in milk per cow. For the year, milk production is expected to be about 0.1% less than in 2008.

The rise in the nonfat dry milk and cheese markets during November and December will contribute to much-welcomed higher milk checks for dairy producers in January and February 2010. However, the recent downturn in the CME spot cheese and butter markets will have a negative impact on milk checks

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KEN'S CORNER



*by Ken Meyers
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Many economic forecasts point to a modest recovery. Within the dairy sector, global demand for whole milk powder, milkfat, whey proteins, whey and carbohydrates has been leading the recovery.

Still, a tremendous amount of uncertainty remains in the marketplace and that is likely to contribute to price volatility in 2010. As we enter the new decade, both the United States and the European Union have excess stocks. In the United States, American cheese stocks are 10.6% larger than a year ago, and the industry didn't experience its typical November drawdown in stocks. Commercial stocks of butter in the United States are 18.5% greater than last year.

In the European Union, the

government is holding a significant quantity of skim milk powder and butter. Just when and how these stocks are released into the marketplace likely will result in unintended consequences.

At the root of this industry is the dairy producer. Around the world, dairy producers were faced with extremely low milk prices in 2009. Even as milk prices improve, it is unlikely producers will respond with significant milk production growth. **MCT**

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Stocks Spook Market

Higher-than-anticipated butter and American cheese stocks have spooked the U.S. domestic market and prices have fallen significantly below world market prices. However, a couple of months of strong exports could tighten U.S. stocks again. In the meantime, CME block and barrel cheese prices are expected to return to a more normal 3-to- 5-

MCT Forecast							
	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
Dec	1.6549	1.4520	1.3968	0.3663	1.283	14.95	14.97
Jan	1.4750	1.4475	1.3750	0.3820	1.300	14.35	14.72
Feb	1.4750	1.4500	1.4000	0.3830	1.300	14.05	14.89
Mar	1.4550	1.4300	1.4450	0.3800	1.275	14.00	14.81
Apr	1.4850	1.4550	1.4450	0.3700	1.235	13.80	14.50
May	1.5650	1.5350	1.4550	0.3650	1.185	14.10	14.00

* Block, barrel and butter are monthly averages of CME prices.
 **Whey and NFDM are monthly averages of NASS prices.

cent spread. And butter prices on the CME are expected to hold at

least until milk supplies tighten further. **MCT**

Dry products strong...

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received by producers in March, which could dampen a recovery in milk production during the second quarter.

Dry product markets are the silver lining in today's dairy markets. From whole milk powder to skim milk powder and from whey protein isolates to lactose, dry product prices have increased

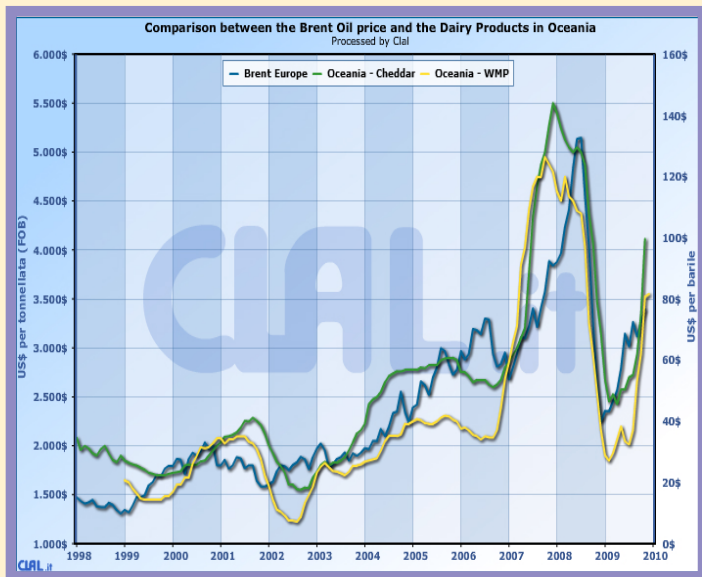
significantly and remain firm, even as cheese and butter markets have retreated. Stronger exports, particularly for lactose and whey products, are buoying these markets. For example, year-over-year U.S. exports of lactose are up 29% due to gains of 84% and 105% to China and Mexico. Likewise, exports of whey protein concentrate are up 15% driven by 46% and 36% increases in exports to Mexico and China, respectively.

(U.S.\$/ton). Major oil producing countries or regions like the Middle East, Russia, Mexico, and Venezuela are also significant importers of dairy products, especially whole milk powder, skim milk powder, butterfat, and cheese.

The chart illustrates that the trend in crude oil prices is similar to that of Oceania whole milk powder and Cheddar cheese prices. Over time, as oil prices have increased, so have dairy product prices. Likewise, when oil prices have declined, so have dairy product prices.

This does not seem to be a short-term trend experienced during the height of 2008's record-high oil prices. Granted other factors, such as supply constraints and currency valuations, also impact this relationship. Nevertheless, it appears that the purchasing power of oil, which has increased almost 47% in November 2009 vs. November 2008, is worth considering in the outlook of global dairy product demand. **MCT**

CLAL, an Italian dairy consulting firm (www.clal.it), provides an interesting insight in the chart at left of the historical European Brent oil prices (U.S.\$/barrel), compared with the Oceania Cheddar and whole milk powder prices



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