



MCTCOMPASS

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2011 Lookin' Up

Here we are again on the cusp of another year. Stronger Asian currencies in tandem with the Russian drought helped support U.S. dairy exports, sending them to record or near-record levels. The U.S. economy, while still a bit choppy, also appears to be in the throes of recovery,



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and consumers are cautiously returning to their pre-recession spending habits. Dairy analysts are bullish on the 2011 U.S. dairy market, particularly the second half of the year.

Milk production in 2010 will be 1.8% higher than 2009 levels, but analysts expect output to slow in 2011, likely even dropping below year-earlier levels in the second half of the year. Following an exceptionally mild summer, third-quarter 2010 milk per cow in California posted an exceedingly strong gain (up 7.7%), but the Golden State will be hard pressed to repeat that performance this coming year.

A rainy winter and a return to normal summer weather in the

West along with high feed costs will likely continue to crimp profit margins and production from coast to coast. USDA's 2011 forecast calls for a 1.3% increase in milk production in 2011, but that could prove high.

Many U.S. dairy producers are still struggling with paying expenses. Some have exhausted their credit lines and chewed through their equity. With margins expected to tighten further in the first half of 2010, both culling and exits will likely increase. While culling generally leads to higher output per cow, milk production should begin to slow from a combination of heavy culling, lower-quality rations, and more producers leaving the business.

The world butter market has been propping up U.S. butter prices, which remain well under world price levels. While butter exports have not returned to the record levels seen in 2008, exports for January through October were

three times larger than the comparable period in 2009.

U.S. exports of nonfat dry milk and skim milk powder (NFDM/SMP) in October of 109.5 million pounds rose 69% above the previous year's 64.6 million pounds. For the January through October period, NFDM/SMP exports of 697.4 million pounds were 48% larger than the previous year's 470.3 million.

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Ken's Corner



*by Ken Meyers
President, MCT Dairies Inc.*

Historically, commodity prices tend to plateau before jumping to a new higher price level. Looking at corn prices over the past century, for example, four new and higher price plateaus have been hit. The first price level, about 50 cents per bushel, lasted until

1916. The second near 80 cents per bushel, lasted until the end of World War II. The third price level near \$1.30 gave way to a newer level in the late 1970s. Some analysts think this fourth level, about \$2.50 per bushel, has crumbled and corn prices are now settling into their fifth higher price plateau.

The same could be happening to dairy product prices. By definition if input costs to produce milk reach a new higher price plateau, the price of raw milk and the resulting dairy products will also need to achieve higher sustainable price levels. These changes are happening on a global scale as developing markets' appetites for all types of commodities increase.

It seems clear the health of the U.S. dairy industry has become intricately tied to world markets. Prices for dairy products—particularly those products developing markets crave most—appear to be seeking a new and higher price level that will continue right into 2011 following a short-lived seasonal downturn. **MCT**

Strong start ...

Most dairy product markets are steady with stronger undertones. The cheese market alone is soft, but

prices are not expected to trade below \$1.30. At the end of November, American cheese stocks of nearly 626 million pounds were almost 43 million pounds greater than last year. Very tight butter stocks of 70 million pounds are 51% lower than in November 2009.

Heavy rains in California led to a state of emergency being issued for six counties. For the past eight months, all of the gain in California milk production was driven by greater output per cow. Adverse weather leading to lower cow comfort on some operations will have a negative impact on milk per cow and total California production. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Dec	1.3775	1.3725	13.90	1.6325	15.25	0.3780	1.2125
Jan	1.3750	1.3550	13.20	1.6650	15.25	0.3790	1.2100
Feb	1.3875	1.3625	13.35	1.7000	15.15	0.3775	1.1850
Mar	1.3950	1.3700	13.40	1.7500	15.20	0.3675	1.1750
Apr	1.4375	1.4125	13.50	1.7800	15.20	0.3675	1.1650
May	1.5000	1.4750	14.15	1.8200	15.30	0.3675	1.1950

* CME prices.

**NASS prices.

lower world output...

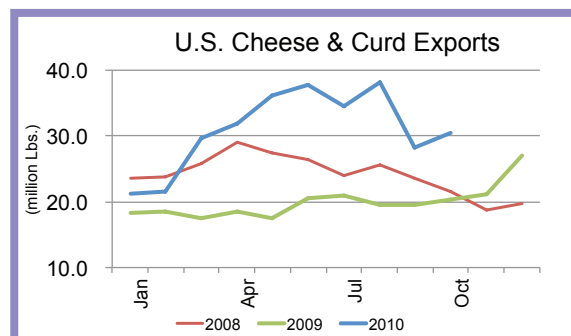
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Forecasts for milk production in the major exporting regions of the world, including Europe and Oceania, have been revised lower in recent months as EU producers struggle with higher feed costs, producers on New Zealand's North Island fight drought, and Australian producers grapple with flooding. USDA expects 2011 EU milk production to remain relatively flat compared with 2010, while earlier forecasts of 5% growth out of New Zealand for the 2010-11 milk production season have been cut to 2%.

At the same time, demand from developing nations is expected to support brisk exports, tightening world supplies of butter and NFDM/SMP. That should send butter and powder prices substantially higher in the second half of 2011.

A recovery in the U.S. cheese market has lagged Class IV products. Over the January through October period, year-over-year American cheese production has grown only 1.4% more than 2009 output. Yet American cheese stocks have been above year-earlier levels in every month of the year.

At the same time, though, U.S. exports of cheese



have hit record levels (see chart), with demand in all of the United States' major markets—Mexico, Far East, and Middle East—up substantially. The drought in Russia has also boosted cheese sales to that country. Cheese demand from these major markets, except Mexico, which has implemented a 25% tariff on U.S. cheese imports, should continue unabated well into 2011. Demand for whey protein concentrates, both domestic and international, is also expected to continue strong.

With feed costs high, world milk production slipping, and demand recovering, 2011 dairy market prices could surpass current expectations. Actual 2011 milk prices will likely far exceed USDA's latest forecast of \$14.85 for the average Class III price and \$14.95 for Class IV. **MCT**



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