

Class IV Run will End

The value of milk used to produce nonfat dry milk/skim milk powder (NFDM/SMP) and butter, known as the Class IV price, has been on an eight-month winning streak compared with the value of milk used to manufacture cheese and whey (Class III price). According to the CME Group's Class III and IV futures, producing NFDM and butter is expected to be more economical than making cheese and whey through 2014. That is very optimistic considering it has never happened before.



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Since 2000, when USDA implemented end-product pricing for Class III and IV milk, the Class III price has averaged 35 cents more than the Class IV price. Looking at the relationship between the two prices from January 2000 through December 2006 and from January 2007 through October 2013 yields similar results. The Class III price averaged 35 cents more for the earlier period and 34 cents more in the latter period.

Periods of sustained price advantages are not unusual. In fact, the last time the Class IV price bested the Class III price it lasted for 16 months, from March 2010 through June 2011. Then

the Class III price topped the Class IV price for 15 months, from November 2011 through January 2013.

It is interesting to note that on a monthly basis the difference between the two prices has narrowed in recent years. For example, during the February through October 2013 period, the Class IV price averaged \$1/cwt. more than the Class III price, compared to \$1.45 more during the 2010-11 period. In 2004, for two consecutive months the Class III price surpassed the Class IV price by more than \$5/cwt. Since 2012, the difference between the two prices for a single month has not exceeded \$2.48. And in 2013 the difference narrowed to less than \$2/cwt.

The latest run-up in the Class IV price can be

attributed to a global reduction in milk output leading to reduced NFDM/SMP production in key regions. The European Union is the global leader in SMP production followed by the United States. Lower year-over-year EU milk production from June 2012 through June 2013 set the stage for higher NFDM/SMP prices in 2013. Then a late

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Ken's Corner



*by Ken Meyers
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One would think that more milk would have flowed into NFDM/SMP production this year due to higher prices, but that has not happened. In fact, U.S. cheese production is up 2.4% through August vs. the prior year, while NFDM/SMP

output trails last year by 1.2%.

Stronger milk production in the traditional cheese-producing regions of the Midwest and Northeast explain this year's greater cheese production. Now that milk production is rebounding in the western United States—where a majority of the nation's NFDM/SMP is produced—output of these products should increase.

Higher Class IV prices (the October price was announced at \$20.20) will continue to attract more milk into powder production, pipelines will eventually fill, and short-term, pent-up demand will be satisfied—in both the U.S. and world markets.

When that happens, Class IV prices will drop below Class III prices again, and cheese makers will attract milk out of butter-powder plants, ramp up production, and deliver more cheese and whey to world markets at more competitive prices. **MCT**

2014 Exports Less Certain ...

The United States has captured global dairy market share as competitors faced supply constraints. U.S. dairy product exports through August 2013 are on

record pace, with sales totaling \$4.34 billion, 23% higher than the same period last year. Total cheese and curd exports set a monthly record in August at 62 million pounds, up 40% vs. the previous year. For the year, cheese trade is up 12% vs. the prior year and accounts for 6% of total U.S. cheese production. August butter exports reached 20 million pounds, the highest in five years. NFDM/SMP trade has exceeded 100 million pounds for five consecutive months. The outlook for U.S. dairy trade in 2014 is less certain as milk supplies around the globe recover. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Oct	1.8230	1.7700	18.22	1.5250	20.17	0.5731	1.8366
Nov	1.8500	1.8200	18.85	1.5450	20.10	0.5750	1.8500
Dec	1.7150	1.6850	18.50	1.5000	19.65	0.5750	1.8000
Jan	1.5900	1.5600	17.00	1.4850	18.30	0.5750	1.6500
Feb	1.5300	1.5000	16.25	1.4450	17.00	0.5750	1.5200
Mar	1.5000	1.4700	15.80	1.4800	16.90	0.5750	1.5000

* CME prices.

**NASS prices.

A turning tide...

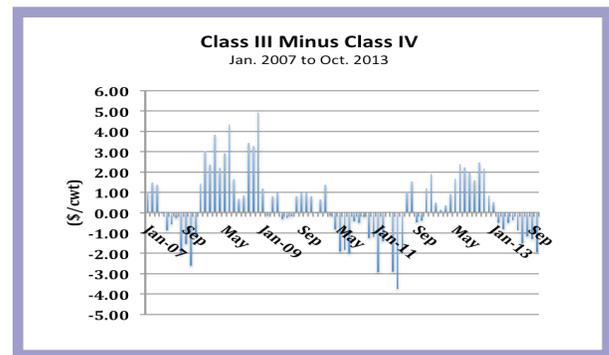
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season drought in New Zealand, the world's third largest SMP exporter, further tightened the global supply, and markets moved higher in Q3 2013. To complicate market conditions, poor farm-level profitability in the western United States, where the majority of U.S. NFDM/SMP is produced, resulted in lower output. Through July 2013, U.S. NFDM/SMP production trailed the comparable period in 2012 by 2.4%, or 33.5 million pounds. The tide turned in August with a 10.7% year-over-year gain in production, the first increase in 2013. Still, year-to-date NFDM/SMP production trails prior-year levels by 1.2%, or 18.1 million pounds.

The United States is not the only region producing more milk than last year. EU milk production increased 2% in July and is expected to run ahead of the prior year into 2014 due to improved weather and farm-level profitability. Likewise, New Zealand milk output is currently at its seasonal peak and estimated to be 4% above last season. Despite the recent upward trend in milk production, milk powder markets remain near

historical highs due to pent-up demand caused by lower production earlier this year.

Looking forward, at some point supply will exceed demand and prices will retreat. If markets follow the same course as in 2010-11 when the Class IV price exceeded the Class III price for 16 months, then the Class III price is due to exceed the Class IV price in May 2014, which coincides with peak milk production in the Northern Hemisphere. **MCT**



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