



# MCT COMPASS

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## Numbers are in, but What do They Mean?

USDA reports that U.S. milk production for May 2005 was a record 15.6 billion pounds. That is a whopping 4.1% more than May 2004 and 4.2% more than May 2003.

A few days later, USDA reported that commercial American cheese stocks posted a more-than-healthy 30.9 million pound build to reach 577.8 million pounds. That is 28.8 million pounds greater than last year's stock level and just shy of the historic high set in May 2000 of 578.3 million pounds.

Commercial butter stocks also increased during May, but not as much as American cheese. Butter stocks increased by 23.7 million pounds to 188.0 million pounds.

That is 9.5 million pounds more than last year, but still 101 million pounds less than May 2003.

So what type of market impact can we expect from all these numbers? Typically, most market participants would expect rising production and stocks to equate to lower product prices. But just the opposite has happened in the marketplace.

When asked, "Why does the butter market continue to rise despite an additional 9.5 million pounds of butter in inventory," someone replied, "Butter stocks are in strong hands."

Is this just another way of saying that the market has not yet increased to the point that a company would be willing to release stocks onto the market? Or is it a reflection that

companies have put away butter for the peak demand period in the fall of the year and are unwilling to release the product at any price?

Butter is the most fungible traded cash dairy commodity at the Chicago Mercantile Exchange (CME) due to its storability and age requirement. For most of the trading year, butter can be traded from several to 12 months of age. This is not the case for Cheddar cheese which must be less than 30 days of age. Therefore, it's possible the butter market may reflect a more macro view of the supply and demand conditions within the U.S. dairy sector.

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## KEN'S CORNER



*by Ken Meyers  
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Suppliers and buyers have a wealth of milk and dairy product supply-side information, granted in hindsight. Getting a handle on the demand side of the price equation is more difficult. At

times there is a disconnect between the publicly available information and current market conditions. This is particularly difficult for buyers because the uncertainty in the market prevents them from buying-in. As a result, buyers tend to go hand-to-mouth. This also contributes to greater price volatility as the

market experiences temporary buying shocks. As we look forward, there is an opportunity to reduce price volatility and sporadic buys in the marketplace. The industry needs to search for acceptable prices with acceptable risk. MCT

## A Mind of Their Own

The market appears to have discounted the latest round of USDA reports, perhaps because they are a snapshot of history and do not necessarily reflect current market conditions. The reports may not even be a good predictor of the future. Today's market conditions are reflective of a "weather" market, which could ignite with additional heat and lack of rain, or fizzle following a rainy weekend. At this

MCT Forecast					
	Block*	Barrel*	Class III	Butter*	Class IV
Jun	1.5065	1.4580	13.95	1.5850	12.40
Jul	1.5800	1.5350	14.55	1.6625	13.30
Aug	1.6350	1.6000	15.25	1.6000	13.10
Sep	1.6750	1.6400	15.75	1.6250	13.10
Oct	1.6800	1.6275	15.85	1.6500	13.15
Nov	1.5675	1.5300	15.30	1.6750	13.15

\* Block, barrel and butter are monthly averages of CME prices.

stage, we recognize some upside price risk, but still expect the markets

to trade below \$1.70 per pound through November. **MCT**

## Where's the Cream...

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A Midwest butter manufacturer recently indicated that his company is receiving 120 fewer loads of cream each week than it was a month ago. The decrease in cream availability may be due to lower milk production because of the recent hot weather, seasonally lower butterfat tests, increased competition from cheese makers demanding more output per vat or greater demand from ice cream manufacturers. In any case, there is less fat going to the butter churn.

The recent rise in dairy product prices after what could be described as "bearish" industry reports may be a function of precautionary demand for dairy products. This concept is adapted from "precautionary demand for money" in which households and businesses hold money to cover unexpected expenses like illness or unemployment.

"Precautionary demand for dairy products" may be described as end users holding dairy products so as to have them available for unexpected

rises in demand or decreases in supply.

The robust 5.6% gain in commercial American cheese stocks during May could reflect strong production, it could also reflect precautionary demand, or it could be systematic of retailers pushing back on their suppliers to hold a greater amount of inventory so they can fill hand-to-mouth purchasing needs.

Nevertheless, with the strength of the world market, CWT looming in the background and extreme heat and dryness across the midsection of the U.S., the market appears to be interpreting more upside than downside risk for the time being.

### A Change a Coming?

The impact of 18 months of strong dairy product prices, however, is beginning to take its toll. Milk production is growing at a record pace and is quickly closing the "gap" between last year's dismal production and population growth. Through May 2005, production is up 2.7% vs. 2004 and 1.5% greater than 2003.

According to USDA, "dairy product demand seems unable to stay fully on track in 2005. Fluid sales and perishable manufactured products have been weak. Commercial use of butter and cheese weakened during the second half of winter quarter and evidently stayed weak in early spring." USDA acknowledges that some of the early 2005 strength was pipeline rebuilding.

Another factor affecting the market is the perception end users have of a "good value." After watching the CME block Cheddar price yo-yo from \$1.48 per pound in early January to \$1.75 by the end of January just to skid to \$1.42 per pound in early February, some end users are reevaluating their risk tolerance and acceptable buy-in price. In most cases, that price level has moved higher over the past 18 months, making one think that the cheese industry has moved to a new and higher price level, at least for the short term. **MCT**

