

## Cheese Volatility Unprecedented

As the demand season drew to a close in mid-November, cheese markets appeared poised to head lower. But then, just when market participants seemed ready to settle in for a stretch of lower prices, bidders returned to the CME spot market the week



before Thanksgiving. However, sellers were, once again, scarce. The late-November volatility was preceded by a year of ups and downs in the cheese market.

*Anecdotally, sellers reported that the third week of November saw some of the strongest shipping days in memory for that time of year.*

On Nov. 21, barrel cheese prices pivoted higher, gaining 3.5 cents after shedding 8.2 cents between the weeks ending Nov. 15 and Nov. 8. CME block cheese prices followed suit. Anecdotally, sellers reported that the third week of November saw some of the strongest shipping days in memory for that time of year. In addition, USDA issued bids on Nov. 14 and 15 for nearly 3 million pounds of cheese for shipment in early 2020, both under the trade mitigation program and for routine cheese needs. Prior to these purchases, demand strength coupled with modest supply gains was reflected in a further whittling

down of national cheese holdings in October. As of Oct. 31, U.S. cheese stocks of 1.34 billion pounds were 2.4% less than year-ago levels. While cheese processors have continued to expand output, adding to the country's overall working inventory, demand exceeded supply throughout 2019, which continuously consumed cheese holdings. These facts and other pieces of the puzzle help to lay out the complete story of the 2019 cheese markets.

USDA's 2019 purchases helped to support domestic cheese markets, while arguably tightening markets and increasing price volatility in the second half of the year. In late May, USDA issued bids for processed and natural

cheese under the trade mitigation program totaling nearly 3 million pounds for delivery between June and September 2019. During that time, Cheddar block and barrel markets appreciated. As the orders were filled, CME spot barrel markets retreated for a time. On Sept.

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### Ken's Corner



*by Ken Meyers  
President, MCT Dairies Inc.*

The CME Group's decision to launch new block cheese contracts shows just how far dairy futures and options have come.

When the current cheese contracts were launched in June 2010, markets were different and the relationship between Cheddar blocks and barrels was far more

predictable. At that time, a single contract based on a blend of block and barrel prices made sense. Today, demand for natural cheese has far outpaced consumption of processed cheese and the share of cheese based on block prices has climbed to an estimated 80% or more leaving less than 20% of U.S. cheese based on CME barrel prices. These shifting dynamics have made the blended cheese futures contracts more challenging to use.

If the new contracts make it through regulatory review, which they should, some are concerned that open interest on the current cash-settled cheese contracts could plunge as hedgers shift away from the blended cheese contracts to the new block contracts. That's the same concern people had about the Class III contracts when the CME launched the first cheese contracts. Both contracts have thrived.

With the difference between the highest and lowest block-barrel price spread now a record-large 80.75 cents, the new block contracts will be a much welcome addition to the dairy portfolio. **MCT**

# Holiday Butter Demand Slows

During the largest shipping month of the year, CME butter prices slipped to their lowest levels for 2019. Once Thanksgiving passes, more cream will

head to butter churns and that butter will end up in warehouses. Futures prices indicate the butter market will decline in December and begin 2020 at a lower

level than today. At the same time, nonfat dry milk (NDM) spot prices have climbed to levels not seen in five years. NDM markets peaked in November at \$1.235/lb., following a strong Global Dairy Trade event, and demand for milk powder remains robust. However, higher prices could take a toll on demand headed into the end of this year. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Nov	1.9725	2.2625	20.15	2.0575	16.54	0.3025	1.1575
Dec	1.9025	1.9100	18.56	2.0025	16.65	0.3300	1.1975
Jan	1.8825	1.8350	18.00	1.9350	16.38	0.3450	1.2000
Feb	1.7275	1.7225	17.11	1.9250	16.27	0.3450	1.1925
Mar	1.7075	1.6825	16.47	2.0525	16.73	0.3525	1.1825
Apr	1.7250	1.6950	16.49	2.0050	16.44	0.3575	1.1725

\* CME prices.

\*\*NASS prices.

## ...USDA purchases add to volatility

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23, barrels were \$1.6124 and blocks were \$2.05/lb., resulting in a record setting block-barrel price spread of 43.25¢. Some reports suggest that the market lull, while fleeting, lasted long enough to allow cheese processors to make additional exports when prices dipped briefly. As USDA's fiscal year, ending Sept. 30, fast approached, the department found additional trade mitigation and Section 32 funds to spend prior to the expiration of the appropriation. USDA issued another bid for nearly 8 million pounds of processed and natural cheese with shipment beginning in December 2019 and ending in first-quarter 2020.

The combination of lower milk intake in the Upper Midwest by barrel processing facilities, larger export commitments, and unexpected USDA purchases sent block and barrel markets racing to multi-year highs. This time, barrels had staying power and block Cheddar prices faded, resulting in a 37.5-cent inverted spread on Nov. 12. The difference between the lowest (inverted 37.5 cents) and the

highest (43.25 cents) block-barrel price spread so far this year was a record-large 80.75 cents, reflecting the greatest turn around ever in a single year. With only a month left in 2019, cheese markets could still break new ground on the gap between the lowest and the highest block-barrel price spread.

The disconnect between CME block and barrel price movements this year and in the two preceding years has made hedging a challenge for even the most seasoned risk management team. To address some of these challenges, the CME Group announced it would be launching block Cheddar cheese futures and options contracts in January 2020, pending regulatory review. The new contracts for 20,000 lbs. will settle to the monthly National Dairy Products Sales Report block price. These new futures and options contracts could provide buyers, sellers, and dairy producers with new tools to mitigate price risk and the market volatility that seems to be increasing with each year. **MCT**



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