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The band is warming up. Toes are tapping. A rhythm is beginning to sway the crowd. Waiting just off the dance floor, the dairy market's youngish bear and the grizzled old bull are sizing up prospective partners. Most are shy, unwilling to commit. Who's going to take the lead? And, what's the tune?

Many are wondering in the middle of this calendar year, during a summer that's keeping us in suspense. The record pricing of 2014 is fading into history but the domestic market remains quite resilient despite the global price suppression, although NFDM (non-fat dry milk) is an exception.

What tune is the band going to play? If there's no recognizable melody, at least what notes or pitch – bearish bass or bullish treble?

Bearish notes

The bearish notes of the international dairy market ring loudly. We heard China's market bubble burst halfway around the world. With the Chinese equity markets tumbling down the scale, we could make the case that they are nowhere near to playing the upbeat dairy import music. Aggressive intervention proved futile in stemming the downside momentum to the point where short sellers in the Chinese equity markets were at risk of arrest and prosecution. The leaders of the band were that desperate to get everybody back in tune.

At the same time, at this writing at least, debtor nation Greece and creditor nations in the European Union could not agree on the key, let alone the song to play. What does this have to do with dairy markets? Recall the sad music of 2008 and 2009, when we learned just how much like an orchestra the global economy had become

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Bears and bulls: Polka dance or Pamplona run?



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and how quickly things could get out of tune to spread disharmony across many markets.

Today, Greece is not the only band whose instruments are in hock. If Greece exits the EU gig, then Spain, Italy, and Portugal must wonder who's going next. Even if Greece gets an encore in the EU, nobody gets a standing ovation. There is only so much the Greek organ grinders can do. The threat to the global symphony of markets remains.

This brings us to Russia, where bears may come out of the woods to scare away other dancers. For example, there's the Russian ban on importation of agricultural products from nations that imposed sanctions because of the military conflict in Ukraine. This ban takes one of the largest importers of dairy products totally out of the market. The sad music is not likely to change anytime soon, which is a heavy downbeat for EU dairy producers. Their milk production quotas came off in April. Some of the EU's leading performers had invested heavily in infrastructure over the past decade in order to accommodate increased milk flows following the lifting of quotas. However, the show must go on, so they're not likely to sit on the sidelines too much longer. When they get out on the dance floor, watch out... excess inventory coming at a time when the usual customers are nowhere to be found.

So that's a look at some bears dancing to the sad music. What about the bulls? Are they within earshot of the happy music?

Bullish resonance

Producers in Oceania have experienced relative hardship as far as pay prices are concerned. Another year of this sad tune is likely to trim back production levels. In my estimation, output is likely to start crimping as soon as the coming season. Cull rates are likely to spike and the music could stop altogether for undercapitalized operations. While this situation is not necessarily a catalyst for a repeat of 2014 dynamics, it does build some floor under international prices.

But the bearish songwriters might ask, "What about El Niño?" Well, what about it?

El Niño is supposed to bring drought relief to California and the West, but the multi-million dollar question is, will it really? El Niño's timing is way off the beat – it's already about three months late affecting the West. It's having more of an impact on the southern tier of Midwest states (which also needed the precip) and the eastern Corn Belt. These regions are doing a lot more singing in the rain than the Golden State. There's still time on the seasonal clock for the current weather pattern to shift, but if it doesn't soon and there is no relief, then the bull could start dancing to a foxtrot.

And let's face it... domestic demand has been a long-running melody. The bullish tune is still somewhere in our Top 40 hit parade. Maybe we're seeing the effects of a genre shift in consumer dietary preference, which seems to be working its way

toward center stage. It's still not quite in the limelight, though. Nobody's singing, "Dairy fat is where it's at." But the trend is there. It's real and it's likely to raise the tempo of the market. On its own, this new happy music is not loud enough to support prices in the midst of a bear market, but it can be counted to play sweetly no matter who is out on the dance floor.

Polka or Pamplona?

Every band has its percussion section and margins in animal industries move their feet – a little or a lot – to the beat of grain prices. So, what about the effect on the dairy markets of the recent rally in grain prices? And, will the rally hold?

Here's the thing... the upside momentum has been largely fueled by fund managers covering previously sold positions, otherwise known as "short covering." This practice has forced weak speculative hands out of their positions as well. Fundamentally, there remains the slow drumbeat of burdensome supplies of corn. Granted, ethanol margins have been good and reflective of very strong production levels. However, if prices continue on their current swing north, those margins will get squeezed and export sales will suffer as well.

Weather is calling the tune for grain. There are real issues with both excessive moisture and a lack of heat to grow corn to the max. The USDA did not reflect these issues in the latest World Agricultural Supply and Demand Estimates (WASDE) report, but come August the ag traders will look for an acknowledgement to come in the form of lower yield expectations. If grain prices remain elevated and milk prices continue to erode, then margins will get pinched and the alarm horn will sound for the dairy industry to cut back production.

Polka for the grain industry could mean Pamplona for dairy producers. Bears and bulls are dancing around, taking turns at leading their partners. But the dance could turn into a frenzy of bulls rushing for an exit. In Pamplona, when the bulls are on the run, onlookers duck into doorways or get trampled and gored.



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