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Butter and cheese. Cheese and butter. Both are distinctive markets and delicious commodities in their own right, which consumers have discovered all over again in recent years. But we're not talking taste here, we're talking fundamentals and market direction.

The butter and cheese markets are behaving according to their own secret playbooks, with cheese on defense of late, and butter, while pulling back a bit over the past month or so, still on the field north of the \$2.00 mark. Strange, isn't it, how markets seem to move on their own volition at times, even for extended periods, without giving in to macro forces? Having followed their own playbooks for the past year, the question is whether current butter and cheese price trends will continue.

Cheese please?

In the cheese market, the fundamentals ordinarily would have mandated a lower price some time ago. Yet prices have held. Is such pricing sustainable in the longer term?

Conventional wisdom would have us look at the ramped up production levels, a strong U.S. dollar, and continued upbeat milk production as reasons for prices to move lower. However, if the cheese market was going to suffer that play, it's likely it would have happened already. At least, that's what many watching the action are saying. To a certain extent I would agree, particularly because international prices are now in relative alignment with our domestic price and demand on the home front remains solid.

At this time of year, both market players and consumers can look forward to the American professional football playoffs followed by the Super Bowl. That's a lot of

Risk Management

Butter and cheese in the playoffs



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pizza. Spot prices continuously find support around \$1.40 and it's irrelevant whether this pricing is defensive or offensive – that is, reflecting actual demand. Until the whistle blows, the resiliency of cheese pricing remains in play.

So, have we bottomed out in cheese pricing? I must say it's been an impressive run but I do not feel like we have reached bottom yet. There are too many external factors that play out on a global scale to say that we've found long-term support. The market has yet to really inflict the kind of pain that would warrant such a bottom. And, while there's nothing in the playbook that stipulates such a game changer, they do happen at times like this. But we have yet to see it.

Granted, cheese futures contracts have been chop-blocked to fresh lows of late, but the bottom isn't just about that. Fresh export numbers have revealed tallies that continue to lag, down 7% from year-ago levels. And, while Mexico did walk on the field, their 5% forward rush was countered by incomplete passes to both South Korea and Japan. Unfortunately, today the game has become more about inflicting enough pain to warrant a spike in cow cull rates and a cutback in production, enough pain to change the momentum of the game to enter a long-term trend. Cheese has gotten banged up at the scrimmage line but remains in the game.

Butter's new playbook

In the Butter Bowl, the Yellow Giant has shown awesome market strength and resolve. Most armchair quarterbacks in the industry have called for a retracement of prices well south of current levels. Despite yours truly cheering from the other side, I have to say, they're probably right. Even so, the shift in game momentum has yet to occur. Here's why, I think: The butter market is playing by a new playbook, possibly for some time already because of back-to-back record pricing years. Maybe those glory years ignited proactive hedge buying programs to spring up like waves of walk-ons and free agents.

Does that mean the butter bubble will burst or the dome will collapse? Heck no. Here's why: Dietary paradigm shifts and milk production disparities on the domestic front, coupled with these new hedge programs will put a floor under the market until further notice. For perspective, butterfat exports were a stark 59% below last month, and, even more staggering to some, off 71% year-to-date. Piling on, without throwing a flag, imports have continued to hit our shores as a result of the strength in the greenback.

This dynamic remains unlikely to change, especially given the hawkish stance adopted by the U.S. Federal Reserve. If we pile it all on, it seems that current butter prices should be history, only a distant memory. But they're not.

Current playoffs

It was about this time last year when we first saw the new defensive plays coming from our friends on the other side of the Big Pond in Oceania. Yes, their milk production levels dipped, but the market was largely expecting that as a result of El Niño.

Today, any downdraft from down under will easily be compensated by increased production out of Europe, not to mention from our own domestic team. Scare tactics about over production won't change the game either, but probably only put off the inevitable, as intervention often does. That said, the markets will play out eventually, with the playbook left on the field for all to see. The rule is that record pricing often is followed by record pricing – whether it be to the upside first or not.

In the current playoffs, the only exception to that rule has been the Yellow Giant, but that too will have its day of reckoning.



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