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Sure, the headline is a cliché and I shy away from using it. However, I don't want you to turn a blind eye to the low pressure zone just over the horizon that threatens to suck more air out of the dairy market.

We've been through some rough seas already this year, where we needed more than small craft advisories to keep afloat. Now we've sailed into calm but uncharted waters. Outside the "yellow giant" butter market, we've seen doldrums develop that have overtaken and quite possibly lulled the trade into a state of semi-consciousness. The drowsiness has appeared in markets for cheese, Class III milk, and NFDM (non-fat dry milk). These strange waters are the culmination of the good sailing of 2014 and the sea change that looms ahead.

Last year was record year with record pricing as a result of aggressive Chinese purchasing that sent shockwaves through the global market, essentially incentivizing production on a broad scale. In the U.S., we've been dealing with the fallout from the implosion of international prices. We lagged the international on the way up and we've certainly lagged on the backside.

Now we're at a point where currents are colliding, where stream meets river and river meets a larger body of water. Fresh and salt water are mixing and I suspect there's a storm brewing.

This inexact weather forecast goes against the conventional weather reporting that believes our domestic market has largely outlasted the storm already and is currently at or near the bottom. I suggest that this view is mistaken, but also acknowledge that any line I draw in the sand here might be overrun by the conventional currents. But looking at clouds on the horizon today, I don't think so.

**Risk Management**

## Calm before the storm



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There's a growing number of bulls coming up on the deck of this ship, but there remains a pack of bears hanging out below, too. That makes me nervous, too, as experience has proven the herd or pack mentality is most often wrong. As the sun sinks during the last months of 2015, I think the majority of dairy market sailors remain between decks – on the fence, not quite bullish yet – waiting for higher prices before they run topside.

But between decks in a choppy sea is a tricky place to be. There is acknowledgement of the global bearishness that continues to overshadow the market. But the greed factor is at play, too. And the greed factor often acts like fear's opposite twin. At times greed is good and fear is evil. I'm pretty sure that this is not one of those times.

Cheese production has ramped up throughout calendar year 2015 with sufficient demand to meet it. It's all been good -- a market in balance if you will. That said, inventory has built up out there and has continued to build.

At some point, our ship is going to encounter the cheese iceberg. The fact that many of the market's sailors are between decks only exacerbates the downside potential. What would that look like? Something along the lines of passengers and crew piling into the lifeboats.

First, there's the moment of realization that things are bad. Although there's the duty to make money, there's also the duty to save money. Life and limb are in danger. So there's a mass exodus from the bullish deck to the lifeboats, which begin to fill with passengers and other sailors. Moving slowly at first, then more quickly. This represents the early moments of the sinking, which we can expect if prices break the lower edge of the year-long range.

But the market exodus quickly builds, which is likely to create the "vacuum trade" that flash crashes are made of. Suddenly, that \$1.40 cheese looks a whole lot better than \$1.20 cheese. The initial deliberate walk to the nearest lifeboat morphs into mob scramble for any already crowded lifeboat. Traders who were holding out for higher prices as the ship of market sailed on calm seas suddenly come to the realization that higher prices are not going to happen.

Cheese is not the only vulnerable ship out there. The same dynamic can occur on the powder ship as the rally in NFDM quelled quickly and sank lower in the water. If we drill down on recent GDT (global dairy trade) events over the past couple of months, the picture becomes clear.

NFDM volume offered was held back in an effort to spark a bid in the market and essentially stem the tide of chronic weakness. It worked. A brief rebound ensued until two recent events when fundamentals once again took over. The global marketplace realized that whatever inventory that was held back still needed to clear. It hasn't yet. Moreover, it wasn't dumped into the ocean and therefore it is still out there.

The main problem on the high seas of the dairy market today is that most end users have sufficient inventory on dry land and are going to let the tides of the market move. In other words, intervention was a “duct tape repair.” Now the market is going to serve its purpose. Price discovery is in the offing, likely at levels that are quite a bit lower from the current board price. It’s a function of supply and demand, fear and greed, and the current flow of the global dairy market.



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