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Dancing to a bearish tune in 2015

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As the record-breaking 2014 calendar year goes down in the dairy history books, let's flip back through some of the pages. We ought to recap where we've been and how we got there. Then we can have a better chance of hearing the tune playing just over the 2015 horizon.

The chapters of 2014 included suspense, drama, and more than a few plot twists:

- Record-paced export marketing
- Extreme drought and heat in California
- Russian dairy ban
- Record U.S. prices

One remarkable twist has been how our domestic prices lagged the international market on the way up in late 2013 and then lagged on the way back down during the second half of 2014. Now, we've come to another turning point where we're staring at current U.S. prices that seem as unrealistic to the downside as the high prices once seemed to the upside.

What got us to this end-of-the-year twist in the plot?

Following the climax of record Class III milk and butter prices in September came the downdraft. Many in the industry had expected it, but some just flat out found it difficult to believe that the crash would come as hard and fast as it did. Over the past couple of months, a plethora of bearish factors have kept domestic prices lower.

What was behind the spike and the fall?

It's been well documented that the breakneck export pace that began in the second half of 2013 ramped the domestic market higher on the back of lackluster Chinese milk production and an unquenchable thirst for product to satisfy China's burgeoning middle class. Chinese governmental intervention and policy reform had been working to transform their industry from smaller, rural-based operations to streamlined, large-scale production, emulating the U.S. industry model. However, the Chinese government overestimated the rate of industry modernization and underestimated the magnitude of the consumer transformation. Therefore, to meet domestic demand in the Year of the Snake, Chinese officials had little choice but to support importation of massive quantities of dairy products.

Then came 2014 and the Year of the Horse. China suddenly stepped to the side of the track when it came to purchasing and has mostly stood there holding the reins ever since. Dismounting from the global marketplace sapped the demand side of the equation and sparked the rapid erosion of prices experienced initially in the international market and more recently here at home.

To add to the downward pressure on prices, factor in the Russian dairy ban, strong production out of Oceania and Europe, "hand-to-mouth" purchasing patterns that accompany market uncertainty, and the U.S. dollar rising to multi-year highs. All of these dynamics weighed down global prices in the last half of 2014 and have shown enough momentum to weigh down 2015.

New Zealand's Fonterra co-op, the world's largest single dairy exporter, recently slashed its forecast farm gate price another 11% to the lowest since 2006-07, which amounts to a little over half of the record price last year.

And, coming in April 2015, there's the expiration of the quota system that currently caps European Union milk production – potentially more mass to move the market lower. The EU already exports more product than the U.S. and modern, efficient dairies in top-producing European countries can boost output quickly.

Make no mistake: Although prices have collapsed, it's doubtful that the lows have been put in.

Even so… all is not lost, depending on your current position and vision going forward. Markets overshoot their targets with regularity and they remain forever cyclical. After the Year of the Horse comes the Year of the Goat.

Yet, while the dairy pit still rings with some bullish fight songs, the bears are calling the loudest tune. To some it sounds like a funeral march. If history is any guide, the dairy bull could be digging out for years to come.

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