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The KDM Dairy Report – January 4th, 2013

What's Bullish:

Futures Month	Class III 01/04	Class III 12/28	Change	Dry Whey 01/04	Dry Whey 12/28	Change	Cheese 01/04	Cheese 12/28	Change
Jan-13	$18.03	$18.10	($0.07)	62.90¢	63.48¢	(0.58¢)	$1.750	$1.760	($0.010)
Feb-13	$18.40	$18.54	($0.14)	59.50¢	60.00¢	(0.50¢)	$1.812	$1.810	$0.002
Mar-13	$18.41	$18.34	$0.07	58.00¢	59.00¢	(1.00¢)	$1.820	$1.815	$0.005
Apr-13	$18.45	$18.38	$0.07	56.08¢	58.00¢	(1.93¢)	$1.830	$1.825	$0.005
May-13	$18.46	$18.44	$0.02	56.00¢	56.00¢	0.00¢	$1.830	$1.830	$0.000
Jun-13	$18.62	$18.53	$0.09	56.25¢	56.75¢	(0.50¢)	$1.850	$1.840	$0.010
Jul-13	$18.70	$18.55	$0.15	55.00¢	55.45¢	(0.45¢)	$1.857	$1.852	$0.005
Aug-13	$18.66	$18.62	$0.04	55.00¢	55.00¢	0.00¢	$1.861	$1.860	$0.001
Sep-13	$18.53	$18.60	($0.07)	54.98¢	54.95¢	0.02¢	$1.851	$1.871	($0.020)
Oct-13	$18.34	$18.41	($0.07)	54.50¢	54.50¢	0.00¢	$1.838	$1.833	$0.005
Nov-13	$18.27	$18.35	($0.08)	54.30¢	54.53¢	(0.23¢)	$1.820	$1.829	($0.009)
Dec-13	$18.15	$18.25	($0.10)	54.30¢	54.50¢	(0.20¢)	$1.795	$1.814	($0.019)
12 Mo Avg	**$18.21**	**$18.43**	**($0.22)**	**56.40¢**	**56.85¢**	**(0.45¢)**	**$1.826**	**$1.828**	**($0.002)**

- Spot Market: Blocks gained 2¢ on unfilled bids to settle at $1.76/lb while barrels picked up a penny to close at $1.72/lb with 13 trades. Butter inched ¼¢ higher to $1.50/lb on 5 trades.
- Dairy Products Report: Cheddar cheese production in November was up just 1.4%, despite strong milk production increases in major cheese-producing states. Butter output fell 6% vs. last November, while dry whey output fell 7.8% and nonfat dry milk output was down 3.8% over the same periods.
- Ag Prices Report: The milk-feed ratio for December was 1.65, down from 1.73 in Nov and well below levels that signal expansion.
- Dairy cow slaughter for the week ended 12/22 totaled 67,500 head, up 7,900 head vs. the same week a year ago. Total dairy cow slaughter for the year was 185,200 head higher than in 2011, up 6.35%.
- Fluid Milk West: Weather conditions in CA are cool and cow comfort is good, but the holidays were almost a nonevent this year. Milk supplies remain behind last year at this time by a significant margin at many operations. Financial stress issues have moderated a bit in the short run for producers, but no one believes that problems are over with. November 2012 pool receipts were 1.6% lower than last year, according to CDFA. Milk production in the Pacific Northwest is mostly steady, making for an uneventful handling of milk supplies over the holiday period. Increased production capacity in the region, with some new manufacturers, has raised expectations for increased local milk demand going into 2013.
- Dry Whey Central: Prices shifted higher as new contract pricing begins. Some uncertainty is noted by market participants as to 2013 availability of Central dry whey due to one plant ending production in the near term. Various buyers report offers of dry whey loads from manufacturers this week were light.
- Cheese West: Western cheese markets are steady to firm. Manufacturers continue to send excess milk supplies from holiday surpluses to cheese plants, and production has increased over the last two weeks. However, cheese supplies are at manageable levels and buyers continue to show interest at current prices.
- International: Dairy prices started 2013 on a firm note at the Global Dairy Trade auction, rising 2%, their highest levels in nearly a year. Doubts over prospects for milk output in New Zealand, the top exporting country, fueled the rise. The increase was led by skim milk powder, which soared 4.7% to a 19-month high of $3,572 a ton.
- International: New Zealand milk production growth rates are easing as the production season progresses. Indications are that seasonal totals through October were up 6%, but forecasts are being set at 0% growth for the total season, projecting further future declines based on lower output per cow and climate. Australian milk production figures for November were pegged at 1% higher than a year earlier. The milk growth rate implications are trending lower, reflective of the drier and sporadically hot weather patterns during the last two weeks. Pastures are being irrigated in the Northern areas to supplement the lack of moisture. Fat and protein levels are trending lower with increased input costs putting constraints on supplemental feeding of dairy cows.

What's Bearish:

- Weekly cold storage numbers indicate both butter and cheese stocks increased during the month of December. Butter stocks at USDA selected storage centers increased 8%, or 376,000 lbs, while cheese stocks increased 1%, or 1.191 million lbs.
- All Class III components were lower in this week's price survey. 40-lb blocks declined 1.9¢ to average $1.76/lb while 500-lb barrels gave up 1¢ to $1.70/lb. Butter lost 4.4¢ to average $1.56/lb, dry whey was down 0.9¢ to 65.8¢/lb and nonfat dry milk shed 4¢ to average $1.52/lb.
- Fluid Milk East: Manufacturing milk supplies in the Northeast remain very heavy and unloading delays to varying degrees are occurring at nearly all plants. Florida milk production has increased following a spell of cooler weather increasing cow comfort levels. Class I demand has weakened and will remain weak until later this week when bottling plants refill pipelines ahead of schools opening next week. The additional milk supplies and decreased bottling demand prompted the export of 188 spot loads of milk this week, up from 94 last week and just 45 a year ago. Cream supplies in the Southeast are burdensome with numerous loads moving to the Midwest at significant discounts. Nearly all available storage facilities including tankers were being used to get through the holiday period and processing the carry over supply will go into next week. Condensed skim supplies also remain heavy with some unloading delays and Class IV production at near capacity levels at many plants.

- Fluid Milk Central: Holiday manufacturing milk volumes in the Central region increased steadily through Sunday and Monday, but now are tapering down as Class II and III plants return to regular milk processing schedules. This week, some spot milk pricing ranged to $6 under Class as the last of holiday milk found processing room. Spot cream availability slowed this week, but remains ample for filling spot needs.
- Fluid Milk Southwest: Weather conditions are much cooler in AZ and NM this week. Cream markets are weak as offerings are heavy. Parking lots are full of trucks of cream waiting to unload at midweek. It will take a number of days to work through the backlog. Stocks of bulk butter are increasing.
- Butter: Cream supplies are very sloppy and churns are working at capacity levels to work through the heavy yearend holiday supplies. The increase in butter production is adding to inventories. Some butter makers have scheduled some domestic and/or export orders to be filled this week, but overall butter production will quickly exceed demand. All varieties of butter, 80%, 82%, salted and unsalted are in production to fill various current and/or possible future needs. Domestic butter demand remains weak. Export demand continues to be fairly good and the 30 day contract extension, averting a Longshoremen's strike, has improved the possibility of future export shipments.
- Dry Whey East: Production schedules for cheese and dry whey have expanded as milk volumes going into vats increased over the holiday period. Current production of dry whey is moving through contracts and adding to inventories. Domestic demand remains lackluster following the holidays. Export demand has slowed with some manufacturers now willing to provide discounts to prompt renewed interest.
- Dry Whey West: The market tone is described as unsettled with domestic prices steady to higher driven by contract indices. Contract buyers are reporting some pushback to the increased prices. Export sales for the week were at significant discounts to domestic pricing and were mostly steady. Whey production is higher as surplus holiday milk went to cheese plants in many cases.
- Cheese East: Cheese production remains at increased levels as holiday period milk supplies have added milk volumes going to vats. Cheese inventories are building with increased volumes of cheese going into aging programs. Domestic demand is fair to good with a number of cheese makers looking for good promotions ahead of the football playoffs leading up to the Super Bowl.
- Cheese Midwest: Cheese production continues at increased levels as holiday milk volumes have expanded cheese makers' milk supplies. Inventories are growing as cheese makers hope for increased promotions ahead of the NFL playoffs.
- Grains: July corn and soybean meal are trading at 6-month lows. If the trend continues, input costs will fall.
- International: Western European milk production has been steady to slightly higher. Supplemental feeding of grains is creating more fat and protein in the milk deliveries. Processing plants were running on extended schedules to process the milk supplies over the yearend holidays. Dairy product marketing has been slow and along expected levels.

Recommendation:

The S&P 500 closed at a 5-year high today on the legs of a fiscal deal that did nothing to address spending. Go figure. The current farm bill was extended 9 months to allow more time for politicians to “fix” things. Despite the bigger events going on, the milk market was very quiet this week, with low trade volume and not much change in prices. Barrel buying was active and international demand seems strong enough that it appears a bottom is being made in cheese prices. Now that the holidays are over, Class I demand will pick up and help get manufacturing milk supplies in better balance. On the international side there is growing concern about how much output Oceania will have in the 2nd half of their season (1st half of 2013). Class III futures remain weaker in Q1, but are starting to firm in Q2. We agree and would not be selling in a big way beyond March. Perhaps the biggest concern now is the falling grain market, where the charts look quite bearish. Should crude oil continue to head lower (some are targeting $55/barrel) due to increased supplies and weak demand, it will only help to pull corn and beans with it. We’re not saying that’s going to happen, but we’re watching it closely. $4 corn would definitely hurt milk prices. But for now, we look at buying $20.50 CALL options Apr-Jun at an avg 25¢/ea., then use them as price targets to market your milk should the rally we’re expecting occur. 2013 is looking like it could be more volatile than 2012. We’ll do our best to help you navigate. We wish all of you a safe and prosperous 2013.