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# The KDM Dairy Report – February 1st, 2013

## What's Bullish:

| Futures Month | Class III 02/01 | Class III 01/25 | Change | Dry Whey 02/01 | Dry Whey 01/25 | Change | Cheese 02/01 | Cheese 01/25 | Change |
|---|---|---|---|---|---|---|---|---|---|
| Feb-13 | $17.18 | $17.02 | $0.16 | 62.50¢ | 59.00¢ | 3.50¢ | $1.669 | $1.668 | $0.001 |
| Mar-13 | $17.26 | $16.95 | $0.31 | 57.48¢ | 55.58¢ | 1.90¢ | $1.700 | $1.680 | $0.020 |
| Apr-13 | $17.41 | $17.30 | $0.11 | 54.43¢ | 53.70¢ | 0.72¢ | $1.730 | $1.742 | ($0.012) |
| May-13 | $17.89 | $17.85 | $0.04 | 54.25¢ | 54.50¢ | (0.25¢) | $1.780 | $1.790 | ($0.010) |
| Jun-13 | $18.27 | $18.37 | ($0.10) | 54.50¢ | 55.25¢ | (0.75¢) | $1.810 | $1.817 | ($0.007) |
| Jul-13 | $18.40 | $18.54 | ($0.14) | 54.50¢ | 56.05¢ | (1.55¢) | $1.826 | $1.835 | ($0.009) |
| Aug-13 | $18.50 | $18.56 | ($0.06) | 54.50¢ | 56.05¢ | (1.55¢) | $1.833 | $1.835 | ($0.002) |
| Sep-13 | $18.57 | $18.49 | $0.08 | 54.25¢ | 55.75¢ | (1.50¢) | $1.841 | $1.835 | $0.006 |
| Oct-13 | $18.38 | $18.32 | $0.06 | 54.25¢ | 54.03¢ | 0.23¢ | $1.826 | $1.815 | $0.011 |
| Nov-13 | $18.17 | $18.18 | ($0.01) | 54.50¢ | 54.50¢ | 0.00¢ | $1.807 | $1.807 | $0.000 |
| Dec-13 | $18.05 | $18.10 | ($0.05) | 54.05¢ | 54.05¢ | 0.00¢ | $1.803 | $1.799 | $0.004 |
| Jan-14 | $17.95 | $17.95 | $0.00 | 48.80¢ | 48.80¢ | 0.00¢ | $1.805 | $1.805 | $0.000 |
| **12 Mo Avg** | **$18.21** | **$17.97** | **$0.24** | **54.83¢** | **54.77¢** | **0.06¢** | **$1.786** | **$1.786** | **$0.000** |

- Ag Prices Report: The milk-feed ratio in January came in at 1.58, down from 1.66 and the lowest since September. Falling milk prices and relatively stable grain prices were the cause.
- Dairy cow slaughter for the week ended 01/19 was the highest in over 7 years. 68,800 head were culled, up 13% vs. a year ago. YTD, slaughter numbers are off to their fastest start in 4 years.
- Fluid Milk East: Class I demand has increased in the Mid-Atlantic and Northeast regions as a number of storm fronts have prompted increased fluid sales. Manufacturing milk supplies have marginally declined as a result of the increase in fluid milk demand. Milk supplies in Florida are in balance with need, which resulted in zero loads of imports or exports. Comments from producers at annual meetings seem to indicate that producers are not inclined to change feed rations until June, which may limit milk production during the flush. The hesitation to change rations is an indication of the tenuous feed supply situation, brought about by high grain prices and the state's increasingly severe drought condition. Milk supplies in the Southeast are, for the most part, in balance with need. Only marginal volumes of milk are being diverted to auxiliary manufacturing facilities.
- Fluid Milk West: Contacts continue to report flat milk production in California. Most do not expect much change through the winter because of the ongoing financial stress at the producer level. Plants are running efficiently with current milk volumes. Milk flow in NM is generally steady with the eastern part of the state experiencing more stress from feed prices.
- CWT has accepted requests for export assistance to sell 7.579 million lbs of Cheddar and Monterey Jack cheese. The product will be delivered February through June 2013.
- International: Milk production in Western Europe is below year ago levels. Ireland and England remain behind year ago levels. Cost of production factors continue to be a limiting influence for milk growth. Euro valuation increases are increasing pricing in the world market and limiting sales. Cheese demand is good.
- International: Australian milk output in December was tracking 2% lower, a level surprising to the industry. Recent weather conditions have been hot in some areas, yet rainy with floods in others. The overall effects are responsible for the decline in the milk flow. Competitive pricing from other world suppliers is noted. Whole milk powder market trends are slightly firmer with demand in play from Asia. Export interest for cheddar cheese is good to Asia at consistent volumes. Australian domestic cheese buying interest remains good as supermarket pricing schemes continue to cultivate active consumer buying. Prices avg $1.81/lb.

## What's Bearish:

- Spot Market: Blocks finished the week unchanged at $1.64½/lb on just 2 trades. Barrels were down 3¢ to close at $1.54¼/lb on 12 trades. Grade A NDM fell a penny to $1.52/lb. Butter bucked the trend, gaining 5¢ to settle at $1.55½/lb with 12 trades.
- Weekly cold storage numbers continue to show a big increase in butter stocks. Holdings have jumped 108% vs. a year ago through the period 01/01 - 01/28. Cheese stocks are still 1% higher, but they were 2.1% higher last week, with 1.1 million lbs coming out of storage.
- Cream: Supplies remain heavy in the East and continue to necessitate cream movement into the Midwest to relieve the burdensome supply. Demand for cream has improved this week, but supply quickly outpaces demand. Most cream based product manufacturing plants have expanded production schedules to take advantage of the readily available supplies and lower prices. Nearly all available churns in the East are operating on expanded schedules with some operations at near capacity levels. Western cream markets are weak. Cream supplies remain heavier than anticipated and some cream continues to move into the Midwest to find buyers willing to take it at some price.
- Fluid Milk Central: Farm milk intakes continue to outpace expectations in the Central region. In some places, milk intakes have outstripped capacity at local processing facilities. A cheese plant operator indicated multiple offers for spot milk were received this week, both for current week processing as well as for the coming month. Here, too, internal milk supplies are ample, and many cheese plant operators are not seeking additional manufacturing milk at this time. A few spot milk loads cleared into Class III operations at $1.50 - $3.00 under Class, but interest is very light.
- Fluid Milk Northwest: Milk receipts in the Pacific Northwest are at expected levels. Weather conditions have been favorable, with no interruptions in milk handling due to winter storms. Receipts are building slowly due to slightly increased herd size in

Washington. Manufacturing capacity is sufficient to comfortably handle current supplies. Although farmers are cautious about increasing herd size, replacement heifers are available at favorable prices.

- Dry Whey East: Most dry whey inventories are expanding as cheese and dry whey production in the Northeast remains on a 6-7 day production schedule. As a way of balancing inventories, some manufacturers have periodically provided significant discounts for multiple load purchases. Domestic demand remains sluggish with numerous potential buyers waiting out the market anticipating supplies will pressure prices lower.
- Dry Whey Central: Conditions in the dry whey market remain lethargic, and prices are unchanged to slightly lower. With readily available spot loads from some manufacturers and resale load offers from brokers and traders, market participants describe the market as flat. With slow decreases in the market signaling the bottom of the market has yet to be reached, buyers are generally satisfying only near term needs. Dry whey production in the Central region is steady to higher at most locations.
- Dry Whey West: Prices are mostly steady to lower. The overall market tone is described as weak. Cheese production in the West is mostly steady although some areas are experiencing lower milk intakes. Nevertheless, available milk continues to be routed to cheese plants. This is contributing to higher than expected volumes of whey in the region. Buyers are cautious to purchase for inventory as futures prices into March and beyond are currently at a discount to offered prices.
- Nonfat Dry Milk: In the East, overall production continues to add to supplies. Some manufacturers continue to offer discounts on spot sales as a way to better balance their inventories. Demand remains sluggish as numerous buyers and end users are trying to wait out the market in anticipation that supplies will pressure prices lower. Central region manufacturers' NDM inventories continue building. A few multi-end product manufacturers indicate they are sending more farm milk loads into nonfat dry milk instead of cheese, as cheese inventories have also been building alongside that unsettled market. Western powder production remains heavy and stocks are heavier than desired at production plants and building. Milk clearing through butter/powder operations is heavier than expected as some cheese plants attempt to limit production by not taking as much milk.
- Cheese East: Milk volumes to cheese plants remain strong keeping cheese operations on 6-7 day production schedules. Production volumes are beyond demand needs and inventories are building. Orders for the Super Bowl are in place, so now cheese makers are hoping for promotions and good sales prior to Easter to help balance inventories.
- Cheese Midwest: The somewhat widespread sentiment two weeks ago that cheese prices were within range of finding a bottom, has been replaced by greater uncertainty over the near term future. This has slowed cheese buying reported by many plants. Milk supplies available for making cheese remain stronger than some cheesemakers care to utilize with present pricing and price trends. Both domestic and export buyers are less motivated to close deals until cheese price declines are perceived to be close to the bottom. With cheese inventories building, some cheese manufacturers with capacity to manufacture other dairy products have begun shifting milk that might have gone into cheese, into butter, condensed skim and some nonfat dry milk manufacturing.
- Cheese West: Prices are lower again this week. Barrel stocks are felt to be long and blocks have followed the lowering trend. Cheese production remains heavy as milk is being channeled to cheese plants. With the weaker prices, buyers are reluctant to order ahead until they feel the market has stabilized.
- International: New Zealand milk production for the month of December was about 8% higher than a year earlier, with the season to date trend at 7% higher. The fantastic run of weather for NZ continues and output continues in line with forecasts.

**Recommendation:**

Despite current fundamentals still solidly bearish, Feb-May Class III futures finished the week in the green, with substantial rallies from mid-week on. March settled 71¢ off its low for the week! Several factors were most likely responsible for the surge. 1.) Technically, the market was severely oversold and just couldn’t go any lower. When you run out of sellers, those that had previously sold the market rushed to buy so they could lock in profits. On Thursday, the March contract had trade volume of nearly 800, yet open interest increased by just over 100. This means a lot of folks closed out positions. 2.) At the IDFA conference this week, there was lots of talk about how the world is going to need our milk, and will pay up for it. Long hedgers may have jumped in to buy futures as a hedge against higher prices later. 3.) Cheddar cheese is $1.90 in the EU, $1.81 in Oceania and $1.67 in the U.S. Export interest is picking up. 4.) The euro rallied to its strongest vs. the USD since Nov, 2011. That makes U.S. product even more competitive on the world market. 5.) Local cheese plants are telling us orders are backing up. 6.) Grains finished higher for the week, breaking some key resistance levels. 7.) Much of the U.S. including the Midwest is still in a drought. By no means are we suggesting the low in milk prices is in and we’re now off to the races. We still have an oversupply of milk, particularly in the Midwest. The Mar Class III contract will start its pricing period in just under 2 weeks, but current spot cheese prices put Class III at about $16.35/cwt. If cheese doesn’t move higher next week, the 91¢ premium that Mar futures currently enjoy will quickly disappear. On that note, we would view the current rally as an opportunity to get some cheaper protection, in case we head right back down. Consider the Mar-Jun 17.00 PUT at 25-30¢ (current settlement is 29¢). This could provide you protection in the near term, where you need it, while staying open for the long term. We agree with the IDFA speakers. The future is bright for dairy; we just need to get through this weak period.