

**The KDM Dairy Report – March 1<sup>st</sup>, 2013**

**What's Bullish:**

- Ag Prices Report: For the third consecutive month, the milk-to-feed ratio has decreased. USDA has Feb at 1.54, down from 1.57 in Jan, and the lowest level since August (see chart).
- Cheese and butter prices increased in the most recent USDA dairy price survey. 40-lb blocks gained 0.4¢ from last week to average \$1.66/lb while 500-lb barrels increased a more substantial 3.8¢ to \$1.63/lb. Butter and NDF were both up 1.7¢ to average \$1.58/lb and \$1.57/lb respectively, but dry whey decreased 0.4¢ to average 63.1¢/lb.

| Futures Month    | Class III 03/01 | Class III 02/22 | Change          | Dry Whey 03/01 | Dry Whey 02/22 | Change         | Cheese 03/01   | Cheese 02/22   | Change           |
|------------------|-----------------|-----------------|-----------------|----------------|----------------|----------------|----------------|----------------|------------------|
| Mar-13           | \$16.79         | \$17.24         | (\$0.45)        | 60.00¢         | 59.00¢         | 1.00¢          | \$1.634        | \$1.683        | (\$0.049)        |
| Apr-13           | \$17.13         | \$17.27         | (\$0.14)        | 56.03¢         | 55.50¢         | 0.52¢          | \$1.692        | \$1.708        | (\$0.016)        |
| May-13           | \$17.43         | \$17.59         | (\$0.16)        | 54.75¢         | 55.18¢         | (0.42¢)        | \$1.731        | \$1.750        | (\$0.019)        |
| Jun-13           | \$17.72         | \$17.92         | (\$0.20)        | 54.75¢         | 55.25¢         | (0.50¢)        | \$1.762        | \$1.780        | (\$0.018)        |
| Jul-13           | \$18.12         | \$18.34         | (\$0.22)        | 54.40¢         | 55.00¢         | (0.60¢)        | \$1.795        | \$1.829        | (\$0.034)        |
| Aug-13           | \$18.33         | \$18.47         | (\$0.14)        | 54.50¢         | 55.50¢         | (1.00¢)        | \$1.829        | \$1.845        | (\$0.016)        |
| Sep-13           | \$18.42         | \$18.48         | (\$0.06)        | 54.50¢         | 54.50¢         | 0.00¢          | \$1.830        | \$1.845        | (\$0.015)        |
| Oct-13           | \$18.26         | \$18.35         | (\$0.09)        | 54.50¢         | 54.75¢         | (0.25¢)        | \$1.820        | \$1.827        | (\$0.007)        |
| Nov-13           | \$18.06         | \$18.12         | (\$0.06)        | 54.50¢         | 54.75¢         | (0.25¢)        | \$1.793        | \$1.804        | (\$0.011)        |
| Dec-13           | \$17.87         | \$18.07         | (\$0.20)        | 54.00¢         | 54.75¢         | (0.75¢)        | \$1.782        | \$1.796        | (\$0.014)        |
| Jan-14           | \$17.80         | \$17.80         | \$0.00          | 48.80¢         | 48.80¢         | 0.00¢          | \$1.805        | \$1.805        | \$0.000          |
| Feb-14           | \$17.58         | \$17.65         | (\$0.07)        | 42.00¢         | 42.00¢         | 0.00¢          | \$1.810        | \$1.810        | \$0.000          |
| <b>12 Mo Avg</b> | <b>\$17.79</b>  | <b>\$17.94</b>  | <b>(\$0.15)</b> | <b>53.56¢</b>  | <b>53.75¢</b>  | <b>(0.19¢)</b> | <b>\$1.774</b> | <b>\$1.790</b> | <b>(\$0.017)</b> |

**Milk-feed Ratio**



- Fluid Milk Florida: Florida's economy is doing well with a warmer than usual winter prompting tourists and seasonal residents' to eat out more often and extend their stays. The improved economy has kept Class I demand strong. Milk production is on the increase, but this year's flush is not as strong as previous years, due to the unwillingness or inability of producers to add high priced grain to their feed rations. Some recent rains in the central and northern portions of the state have helped, but more rain is needed to relieve drought stricken areas. Pasture and forage regrowth remains slow with 80% of the pastures rated as fair or poor.
- CWT has accepted requests for export assistance for 908,305 pounds of butter and 1.122 million pounds of Cheddar and Gouda cheese. The product will be delivered February through July 2013.
- International: New Zealand milk production is trending lower seasonally. Hot and dry conditions are impacting the milk flow on the North Island. Pastures are drying up and producers are drying off milk cows sooner than expected. Higher cow slaughter rates are noted for this time of the season, which are a result of conditions. Milk processing plants are running on reduced schedules with products of greatest need being made. Australian milk flow is declining and the current rate is trailing last year at this time. Milk intakes are often behind budget for processors. January milk output is 5.5% lower than a year earlier and trailing year ago levels in all but one region. The extension of the decline into February is described as grim. Lower milk receipts will affect the production of late season products and raising concerns. Producers continue to feel the squeeze of high feed cost in comparison to the current milk prices. Dairy product prices in the Oceania region are steady to firm. Demand is good across product categories. Export interest is active and working stocks are moving on schedule.

**What's Bearish:**

- Spot Market: In light of ample supplies, both spot cheese and butter prices fell this week. Blocks were down 5¼¢ to \$1.57½/lb on 9 trades, while barrels fell 7¢ to \$1.56/lb on 10 trades. Butter was not immune, declining 1½¢ to \$1.57½/lb on 8 trades.
- Fluid Milk East: Milk production continues to expand in the East, adding to the already ample manufacturing milk supplies in the Northeast and Mid-Atlantic regions. Class I demand has leveled off in both regions. Milk production in the Southeast continues to increase. Production is exceeding Class I demand with more loads moving to manufacturing plants. Demand for cream, though it has improved, cannot keep up with supply. Spot loads continue to move to the Midwest at significant discounts.
- Fluid Milk Central: Several balancing plants experienced pushback from fluid accounts where bottled milk was scheduled for delivery into school systems. Cream is readily available in the Central region. Some Central balancing plants indicate cream sales into the East region have declined as yogurt plants in the East began spinning off cream. That cream is filling East demand and

also spilling into the Central region. Some milk marketers report a few cheese plants are pushing back on milk supplies because of existing cheese inventories. Spot milk prices remain below Class for most transactions.

- Fluid Milk West: Weather conditions in CA are good for current milk production. Manufacturing plants in state are running well with cream supplies remaining heavy. Weather conditions have settled down this week in AZ. Output is back on track to hit the seasonal peak soon.
- Butter: Production is described as strong in the Northeast, heavy in the West and active in the Central Region. Cream in the East is plentiful enough to more than fulfill regional needs and augment Central region supplies. Western manufacturers are mixed on storing butter for inventory or beginning to clear product. Though butter demand is good in the Northeast, production continues to add to inventories at some plants.
- Cheese: Markets across the U.S. continue to look for a clear price direction. Higher than expected milk volumes are headed towards cheese plants in the East and Midwest. This is leading to increased production and inventory. Due to less than hoped for demand, some plants are pushing back on excess intakes to balance inventories.
- Dry Whey: Prices declined this week. Dry whey production is robust with most cheese plants operating on 6-7 day production schedules. Inventories are expanding and manufacturers are offering block loads at discounts in order to better manage their supplies. Domestic demand remains lackluster with buyers unwilling to greatly expand inventories on a downward trending market.
- International: Milk production for Western Europe countries is mostly steady. The declining Euro value against the U.S. Dollar is helping to make pricing more competitive with other world sources, more so for skim milk powder and whey. Dry whey prices are under pressure from a slow domestic and export demand from feed and food accounts.

#### **Recommendation:**

The “numbers game” finally caught up to March Class III futures this week as it shed 45¢, settling at \$16.79. Spot prices keep falling, and they eventually show up in the weekly price survey, which is used to calculate the USDA “announced” price. With virtually two of those 4 weeks “in the book”, and current spot prices working out to just about \$16.40, the market finally took away some of premium the March contract had in it. Double-digit losses were also seen in the Apr-Aug contracts, with lighter losses beyond. Fundamentals suggest more milk in the Midwest and East over the next 30-60 days as output approaches the peak in these areas. This will most likely depress prices further, or at least limit major gains. However, there is a storm brewing. International dairy demand is growing at a healthy clip, while most other parts of the world are losing milk production. We would still be willing to sell a rally in March, but we wouldn’t chase Apr on out much lower than current prices. If cheese keeps falling next week, buyers will most likely get more and more aggressive as they see better and better value (and the ability to store/age it until prices are higher later this year). If you have milk marketed in Q2-Q4, we would recommend getting more aggressive in protecting the potential upside by purchasing CALL options. This is basically insurance for higher prices (which is a risk if you have already sold the milk). See what is available \$1.00 – 1.50 above you sell price. It’s ok to give up some upside, but much more than a dollar and it starts to hurt!

This material has been prepared by a sales or trading employee or agent of R.J. O'Brien and is, or is in the nature of, a solicitation. This material is not a research report prepared by R.J. O'Brien's Research Department. By accepting this communication, you agree that you are an experienced user of the futures markets, capable of making independent trading decisions, and agree that you are not, and will not, rely solely on this communication in making trading decisions. DISTRIBUTION IN SOME JURISDICTIONS MAY BE PROHIBITED OR RESTRICTED BY LAW. PERSONS IN POSSESSION OF THIS COMMUNICATION INDIRECTLY SHOULD INFORM THEMSELVES ABOUT AND OBSERVE ANY SUCH PROHIBITION OR RESTRICTIONS. TO THE EXTENT THAT YOU HAVE RECEIVED THIS COMMUNICATION INDIRECTLY AND SOLICITATIONS ARE PROHIBITED IN YOUR JURISDICTION WITHOUT REGISTRATION, THE MARKET COMMENTARY IN THIS COMMUNICATION SHOULD NOT BE CONSIDERED A SOLICITATION. The risk of loss in trading futures and/or options is substantial and each investor and/or trader must consider whether this is a suitable investment. Past performance, whether actual or indicated by simulated historical tests of strategies, is not indicative of future results. Trading advice is based on information taken from trades and statistical services and other sources that R.J. O'Brien believes are reliable. We do not guarantee that such information is accurate or complete and it should not be relied upon as such. Trading advice reflects our good faith judgment at a specific time and is subject to change without notice. There is no guarantee that the advice we give will result in profitable trades.

© Copyright 2013 - KDM Trading, Inc. All Rights Reserved – www.kdmtrading.com