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The KDM Dairy Report – April 5th, 2013

What's Bullish:

Futures Month	Class III 04/05	Class III 03/28	Change	Dry Whey 04/05	Dry Whey 03/28	Change	Cheese 04/05	Cheese 03/28	Change
Apr-13	$17.52	$17.26	$0.26	58.00¢	58.00¢	0.00¢	$1.724	$1.699	$0.025
May-13	$18.34	$18.34	$0.00	57.15¢	56.80¢	0.35¢	$1.810	$1.805	$0.005
Jun-13	$19.33	$18.95	$0.38	58.75¢	57.50¢	1.25¢	$1.896	$1.865	$0.031
Jul-13	$19.37	$19.16	$0.21	60.25¢	57.75¢	2.50¢	$1.898	$1.889	$0.009
Aug-13	$19.38	$19.13	$0.25	61.25¢	58.50¢	2.75¢	$1.883	$1.885	($0.002)
Sep-13	$19.38	$19.10	$0.28	61.50¢	59.00¢	2.50¢	$1.891	$1.880	$0.011
Oct-13	$19.22	$18.90	$0.32	61.25¢	58.00¢	3.25¢	$1.870	$1.863	$0.007
Nov-13	$18.86	$18.63	$0.23	61.00¢	56.00¢	5.00¢	$1.843	$1.840	$0.003
Dec-13	$18.46	$18.26	$0.20	59.50¢	55.50¢	4.00¢	$1.811	$1.800	$0.011
Jan-14	$18.02	$17.87	$0.15	54.35¢	48.83¢	5.53¢	$1.797	$1.805	($0.008)
Feb-14	$17.64	$17.65	($0.01)	48.00¢	42.00¢	6.00¢	$1.807	$1.810	($0.003)
Mar-14	$17.45	$17.35	$0.10	48.00¢	42.00¢	6.00¢	$1.800	$1.815	($0.015)
12 Mo Avg	**$18.58**	**$18.38**	**$0.20**	**57.42¢**	**54.16¢**	**3.26¢**	**$1.836**	**$1.830**	**$0.006**

- Spot Market: Blocks gained 7¢ to $1.76¼/lb on 5 trades and barrels jumped 9½¢ to $1.69¼/lb on 7 trades as buyers aggressively sought after product. Butter was 8¢ higher to $1.71/lb on just 3 trades, while Grade A NDM shot up 12¼¢ on 3 trades to settle at $1.68¼.
- Cheese and butter prices were higher in this week's dairy price survey. 40-lb cheddar blocks increased 1.1¢ from last week's survey, to average $1.62/lb, while 500-lb barrels jumped 3.2¢ to $1.65/lb. Butter increased 2.9¢ to average $1.66/lb, but dry whey lost a penny to 58.2¢/lb and nonfat dry milk gave up 0.3¢ to average $1.51/lb.
- Dairy cow slaughter remains robust. 64,400 head were culled during the week ended 03/23, up 4.7% from the same period a year ago.
- Fluid Milk East: Manufacturing milk supplies in the Northeast and Mid-Atlantic regions were heavy going into the holiday weekend, but were somewhat lighter coming out of the weekend, due to increased Class I demand. Florida's Class I demand declined this week as most schools in the state are on break, but it has held up better this year than in previous years. The improved demand can be partially attributed to the increased popularity and expansion of soft serve frozen yogurt operations, which uses Class I milk in their soft serve machines. Milk production has reached its peak and has begun to decline. Cow comfort levels are declining as the weather has turned hot and dry with daytime highs in the mid 80's. Hay supplies are getting harder to come by and higher priced as drought conditions have worsened.
- Fluid Milk Central: Milk marketers indicate fewer loads of spot milk were offered to the market this week in the Central region. Spot prices ranged from flat Class to $3 under. Fluid orders are expected to increase starting on Friday, as schools come off of Spring Break. Opinions vary on whether the Central region will experience a traditional flush season or a milk production pattern that hits a lower peak and continues for a longer period. Cream supplies in the region are clearing readily into Class II outlets after a busy weekend of churning.
- CWT has accepted requests for export assistance to sell 1.636 million lbs of butter and 5.899 million lbs of cheddar cheese. The products will be delivered April through September 2013.
- Dry Whey East: Demand has shown some increase and there is the feeling among some market participants that prices may be at or near their low point. Increases in the nonfat dry milk market may have the effect of raising prices for whey as some buyers look for lower priced proteins.
- Dry Whey Central: The current overall market tone is unchanged for Central dry whey, although some market participants indicate they feel the market is close to reversing its downward trend. Multiple load transactions have reportedly lightened inventories.
- Dry Whey West: Prices were mostly unchanged as the market experienced a shift in tone. Production continues to be heavy as cheese plants are busy with current milk supplies, but spot sales to the export market have improved and helped to clear some excess inventory. Whey is still available for spot purchases, but there is less urgency to clear product. Recent reported firmness for dry products into international markets has added to the change in thinking.
- NDM East: Prices moved significantly higher this week. The market became very active after skim milk powder prices sharply increased on the g/DT auction for skim milk powder. By mid-week, few or no loads were being offered by manufacturers. Production of nonfat dry milk remains strong, but demand for product has increased as many buyers see little downside risk in the current market. The market undertone has gone from weak, to unsettled, to firm in a short period, primarily due to the New Zealand drought and its impact on global demand.
- NDM Central: Prices stepped higher this week as the latest globalDairyTrade auction results spurred renewed interest from many end users and resellers. Some manufacturers indicate recent sales have outstripped inventories as well as projected production for April, thus, new market entrants may have to wait for NDM.
- Cheese East: Production has marginally declined this week as increased Class I demand has resulted in lower milk volumes going to cheese plants. Cheese demand has surprised some cheese makers and has held up fairly well coming off the holiday weekend. Mozzarella demand has especially been good, prompted by good pizza promotions and sales. Export demand continues to be active supported by assistance programs.

- Cheese Midwest: Cheese production remains strong in the Midwest, but solid domestic and export demand are keeping inventories from building too quickly. Milk is readily available and in some areas, components exceed last year, which is also helping some Midwest cheese plants continue with production to meet good export demand.
- Cheese West: Production is mostly steady with some increases reported and other places holding the line on production schedules. Export demand is good as the U.S. prices continue to be competitive on a world basis. Retail demand is good at current price levels.
- International: The drought in New Zealand made an impact on the twice monthly Global Dairy Trade auction, as prices for dairy products shot up an average of 14.2% from the prior auction just 2 weeks ago. Skim milk powder made the biggest move, jumping 27.8% to a U.S. equivalent of $2.33/lb. AMG increased 6.7% to a U.S. equivalent $2.13/lb while cheddar cheese was up 6.6% to a U.S. equivalent $2.10/lb.

What's Bearish:

- Packaged fluid milk sales in January were down 2.1% vs. Jan 2012.
- Fluid Milk West: CA milk output is trending higher on a week-to-week basis. Weather conditions are good and new crop feed is giving some boost to the milk flow. Most processing plants are working on longer schedules to handle the available milk supplies. Class 1 interest is often lower than projected. AZ milk production remains at seasonal high levels and is thought to be at the peak. Weather conditions have been ideal with warm daytime temperatures and cooler nighttime conditions. Processing plants are running on extended schedules to process the milk supplies. Weather conditions in the Pacific Northwest are favorable for dairy cattle. Along the coastal areas pastures are green and dairy cattle are able to graze fresh grasses. Milk production is building slowly. Milk supplies in Central Washington are increased from a year ago as some dairies have increased cow numbers. UT and ID milk supplies are steady to increasing with moderate weather conditions. Hay crops are greening and dairies are looking forward to fresh forages. High cull cow prices are helping dairies to replace older cows with heifers to increase production with minimal costs incurred.
- Butter: Cream supplies were very heavy going into the holiday weekend keeping churns operating at/or near capacity. Domestic demand for butter has declined following Easter. Current production is adding to most manufacturers' inventories.

Recommendation:

Like it or not, we are tied to the global market. For two straight years the U.S. has exported more than 13% of its milk solids (both records). Because milk and its end-products are perishable, we also know that prices are highly sensitive to small changes in supply and demand. The CME Group's latest brochure titled "An Introduction to Trading Dairy Futures and Options", states that:

The dairy markets are unique in that they react very dramatically to small changes in supply and demand. Reductions in supply of 1 percent or less can send prices soaring 50 percent or more within a few months. Increases of 1 percent or less can send prices reeling by the same magnitude.

No doubt, the current drought in New Zealand is having a positive impact on U.S. dairy prices. Tuesday's big move higher in GDT prices caused quite a rally in Class III futures almost immediately. If world buyers are forced to source more dairy product from the U.S., perhaps we'll break a new export record in 2013. Even a 1% increase in demand would cause quite a move. It is a butter/powder rally that is powering us higher. We have plenty of cheese. This week's spot market gains saw Grade A NDM with the biggest move, followed by butter. The impact it's having is this. At current spot prices, Class IV milk works out to about $19.80/cwt while Class III is at about $17.70/cwt, more than a $2/cwt spread. If we plug GDT numbers into our formula, Class IV works out to nearly $28/cwt. We're not trying to imply we will get there, but if demand for butter and powder persists, it should continue to lift our spot prices. Should our Class IV price continue to increase, it will drag Class III along with it, as the spread cannot stay too wide for too long. If nothing else, it will attract more milk into the churn and drying operations to satisfy demand, and less into the vat. This all sounds pretty bullish, and it is, so we need to temper our bullish enthusiasm here. Grains stayed in a bear market all week, with beans pushing into lows not seen since last summer. New crop corn is threatening to make new lows as well. Unless we have our own weather event this summer, feed will be getting quite a bit cheaper. Combined that with the outlook for some very profitable milk prices and it sets us up for a huge increase in production for late 2013 into 2014. While a 1% increase in demand has a very positive affect, a 1% (or more) increase in supply can do just the opposite! 2014 could be quite a bear milk market. With an average at $19.11/cwt, futures are predicting we'll have $1.90+ cheese the entire 2nd half of 2013. We've never achieved that before. Don't get too greedy. Consider lightly selling some of your production at $19.30 avg or higher. Sure, we could go to $25 milk, but we know in the past it has killed demand….quickly. If you don't want to sell, consider putting a fence around your milk price; either a 17.00 x 22.00 or a 18.00 x 21.00. This lets you rally with prices if they go higher, but also establishes a floor at a reasonable level should prices tank without warning. And watch the 2014 contracts. If they drift into the $18's this summer/fall, we'll probably advise getting some milk covered. Volatility looks to ratchet higher over the coming weeks/months. Hang on!