

The KDM Dairy Report – June 7th, 2013

What's Bullish:

- Spot Market: Blocks gained just ¼¢ to settle at \$1.74¼/lb, but did so on sales of 50 loads. Barrels jumped 5¼¢ to close at \$1.76/lb on just 4 trades. Butter picked up ½¢ to settle at \$1.54½/lb on 20 trades, while Grade A NDM was up 1¼¢ to close at \$1.69¼/lb on no trades.
- Dairy Products Report: Butter output in April was down 0.3% vs. a year ago and down 6.9% from March, while nonfat dry milk production fell 15.7% from last year.
- Nearly 2 million acres of alfalfa have been lost to WI and MN dairy farms due

Futures Month	Class III 06/07	Class III 05/31	Change	Dry Whey 06/07	Dry Whey 05/31	Change	Cheese 06/07	Cheese 05/31	Change
Jun-13	\$18.09	\$17.78	\$0.31	58.28c	58.00c	0.27c	\$1.774	\$1.747	\$0.027
Jul-13	\$18.58	\$18.39	\$0.19	59.00c	58.25c	0.75c	\$1.831	\$1.806	\$0.025
Aug-13	\$19.05	\$18.70	\$0.35	59.50c	58.75c	0.75c	\$1.867	\$1.835	\$0.032
Sep-13	\$19.08	\$18.91	\$0.17	59.50c	58.00c	1.50c	\$1.874	\$1.859	\$0.015
Oct-13	\$18.87	\$18.78	\$0.09	59.98c	58.00c	1.98c	\$1.852	\$1.854	(\$0.002)
Nov-13	\$18.54	\$18.47	\$0.07	59.00c	58.00c	1.00c	\$1.820	\$1.825	(\$0.005)
Dec-13	\$18.13	\$18.00	\$0.13	59.00c	57.98c	1.03c	\$1.780	\$1.775	\$0.005
Jan-14	\$17.65	\$17.50	\$0.15	54.35c	54.35c	0.00c	\$1.745	\$1.745	\$0.000
Feb-14	\$17.30	\$17.30	\$0.00	50.00c	50.00c	0.00c	\$1.726	\$1.750	(\$0.024)
Mar-14	\$17.15	\$17.15	\$0.00	49.00c	49.00c	0.00c	\$1.730	\$1.742	(\$0.012)
Apr-14	\$17.13	\$17.20	(\$0.07)	48.00c	48.00c	0.00c	\$1.727	\$1.752	(\$0.025)
May-14	\$17.13	\$17.12	\$0.01	48.00c	48.00c	0.00c	\$1.720	\$1.747	(\$0.027)
12 Mo Avg	\$18.06	\$17.94	\$0.12	55.30c	54.69c	0.61c	\$1.787	\$1.786	\$0.001

- to the extended winter, according to an article this week in the Pioneer Press. Those that have to replant will be lucky to get one or two cuttings, increasing the feed component pricing of their operations.
- Some dairies in SE MN are running out of feed fast due to lost alfalfa, according to an article in AgWeb. As much as 80% of the hay crop is lost. As a result, reports of much heavier than normal culling of dairy cows has been reported in the area.
- Fluid Milk Southwest: Temperatures approaching the 113 mark by the weekend are possible in the southern Central Valley of CA. This would be near a record and quite early for heat this intense. Weather conditions in AZ are starting to add much more stress on the milking herd. The temperature is getting into the 80s much more quickly in the mornings. Near record heat is possible by the weekend as the thermometer may be in the 110 range. NM temperatures were high early in the week with the 100 degree mark being touched. Tests on milk receipts are declining seasonally. Cream markets are being called steady. Ice cream operations are taking some increasing volumes of cream. Very little cream is leaving California at this time.
- Dry Whey East: Prices moved marginally higher this week. Production of dry whey remains very active and domestic demand is light. However, most manufacturers do not view their inventories as burdensome. Some have been able to better manage their inventories through export sales.
- Dry Whey Central: Prices were slightly higher and various end users indicate offers from resellers were lighter this week. Some brokers/traders commented they see opportunities in the near future to recoup costs on some of the whey loads if this market follows the expected firming trend during the summer months. Some Central dry whey manufacturers report export sales to Southeast Asia increased compared to a few weeks ago.
- Dry Whey West: Prices firming slightly this week as export sales reported steady prices with a firm undertone. Whey production levels are mostly steady with some additional product from higher cheese production. Demand is reported to be good with stronger international interest. Current stocks are said to be adequate for immediate needs from both manufacturers and brokers.
- Cheese Midwest: There have been recent indicators of buyers waiting to place purchase orders until they believed the recent price declines had moved toward a low. Last week, some manufacturers noted increased inquiries asking about block availability. A cheese manufacturer observed that the normal seasonal trend for cheese markets is higher for coming months.
- CWT has accepted requests for export assistance to sell 2.075 million lbs of Cheddar and Monterey Jack cheese to customers in Asia and North Africa. The product will be delivered June through November 2013.
- International: China's Ministry of Agriculture stated this week that there is limited potential for the Chinese domestic dairy industry to grow. The agricultural sector faces many challenges, including limited water and land resources and a very large population.
- International: Western European milk production is mostly steady with some areas being affected by adverse weather conditions. Flooding and wet conditions are common over some areas of Europe and the wet conditions are preventing pasturing of stock and the cropping. Milk production has likely peaked for the season. Dairy products are trading along expected volumes with buyers more active in seeking future needs.
- International: New Zealand milk output is slowing at levels along seasonal trends. Overall, milk remains at levels below a year ago. The effects of the March drought remain a strong influence on the current production cycle. Despite recent wet conditions, there has been limited response to milk production. Australian milk production trends remain below year ago levels in most milk producing regions. Farm economics and the effects of weather conditions continue to put a damper on current milk production. Dairy product prices at current levels and offerings are creating a sense that markets could gain support. Current offering volumes are light from Oceania sources. Short-term offerings have slowed as products are moving to fill contracted volumes and to products of greatest needs.

What's Bearish:

- Dairy Products Report: Cheese output in April was higher than year-ago levels. Cheddar production jumped 4.4% while total cheese output was 3.2% higher than in 2012.
- For the third week in a row, dairy cow slaughter trailed year ago numbers. 56,800 head were culled during the week ended 05/25 vs. 57,200 during the same period in 2012.
- International: The average price for dairy products in this week's GDT auction fell an average 5.3%. Cheddar cheese prices were unchanged, but whole milk powder declined 7.1% and anhydrous milk fat was down 4.2% from the prior auction.
- Fluid Milk East: Manufacturing milk supplies remain very heavy in the Mid-Atlantic and Northeast regions as milk production has plateaued at levels just beyond the seasonal peak. Balancing plants are doing all they can to keep milk from hitting the ground. Unloading delays are occurring in some areas of the Northeast. The recent heat wave that covered much of the East Coast did little to limit milk production as night time lows allowed cattle to recover from the daytime highs. Milk supplies remain heavy in the Southeast Region with nearly all auxiliary manufacturing plants being utilized to handle the increased supplies. Class I demand has marginally rebounded in some areas, but not enough to stem the flow of milk to manufacturing plants. Demand for condensed skim remains flat with most manufacturers able to meet their needs via contracted supplies. The heavy supplies are keeping most drying operations operating at or near capacity levels.
- Fluid Milk Central: Manufacturing milk supplies in the Central region are steady to increasing as demand from bottlers recedes with the end of school terms. Demand for spot loads of milk is generally light. Some cheese manufacturers offered loads to the market, hoping for premiums, but offers centered around flat Class.
- Fluid Milk Pacific Northwest: Moderate temperatures are helping to add to cow comfort levels. Milk production levels are steady to increasing slowly. The closing of schools across the region has added to manufacturing milk supplies. Hay prices in the region are coming down as harvest of first crop hay has begun. UT and ID milk volumes are mostly steady to slightly improved as moderate temperatures continue in the area. Milk processors are able to handle current supplies with some reports of additional milk available for those plants with surplus capacity. Current high cull cow prices at auctions have helped dairies to replace lower producing cows at a faster pace as some prices have topped \$80.00 per cwt.
- Butter: Western butter buyers are looking for discounts for sales above immediate needs. Increased inventories continue to weigh on the market. Western manufacturers are looking at export opportunities to move inventory and some have increased production of 82% butterfat to fill that need. The Central butter market is steady. Butter churn operators continue to buy spot cream loads for churning, as long as multiples are below the mid 1.30's. Butter production continues at an active pace in the Northeast with plenty of cream finding its way to the churn.
- Cheese East: Manufacturing milk volumes going to cheese plants remain strong with most plants on 6-7 day production schedules. Cheese sales have slowed and are unable to keep up with current production schedules. Export activity continues, but at lower volumes compared to earlier in the year.
- Cheese West: Buyers are cautious about advance purchases as they assess the weakness in the market. Export sales have slowed with some manufacturers offering discounts to move product.

Recommendation:

With the spotlight again on the large spread between international and spot cheese prices, buyers in this week's cash market appeared intent on picking up as much "bargain-priced" cheese as they could. A whopping 54 loads of cheese representing over 2.25 million lbs exchanged hands, and left the block/barrel spread inverted (barrels higher than blocks). This should mean blocks will continue to be bid next week to correct the spread. The current excess in both milk and cheese output has put cheese stocks at near record levels, but buyers this week appeared anxious to put a dent in that. At the same time, international demand for Q3 needs appears to be picking up. Thinking U.S. cheese prices may have put in a bottom could also have served as motivation for this week's buyers. Both dry whey and NDM demand seems to be putting a firm underpinning to these markets. Lastly, the current alfalfa shortage in the Midwest and 100+ heat headed to the West may have some thinking that today's surplus supplies could quickly become tomorrow's shortages. Grain prices surged this week as cold and wet weather further delays soybean planting. Chicago meal prices through the Sep contract are once again well above the \$400/ton level, while the Oct and Dec contracts are nearly there at \$395-397/ton. The combination of expensive forage and protein combined with a return to summer temps in parts of the U.S. may be all that was needed to fire up the rally engine. While we pointed out last week we had a bias to the upside from here, as a hedger, you shouldn't bank on that. We're human and make mistakes. Rather, you should once again concentrate on preserving income. Assuming prices are headed up in the near term, we would look at PUT options to get a floor price under you milk, while leaving the upside open. Consider buying the July-Aug 18.25 PUT at 25¢/avg and the Sep-Oct 18.00 PUT at 30¢/avg. For producers receiving good component pay, it should provide cash flow positive insurance into 4th quarter.

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