

**The KDM Dairy Report – July 5<sup>th</sup>, 2013**

**What's Bullish:**

- Spot Market: Blocks gained 2¼¢ for the week on 13 trades to settle at \$1.67/lb while barrels jumped 7¼¢ to close at \$1.67/lb on 15 trades. Grade A NDM was up 1¢ to settle at \$1.74/lb with 3 trades, and butter shot up 9¼¢ to \$1.52½/lb on 13 trades.
- Fluid Milk West: The forecast for CA is for at least another 10 days of 100 plus temperatures. The regional high in the dairy areas seems to have been 112. Contacts expect to see a real downturn in milk supplies by midweek as the heat begins to have a cumulative effect. Also, some more humidity is noted. Pasture and Range conditions in the West continue to deteriorate. Each week the

Futures Month	Class III 07/05	Class III 06/28	Change	Dry Whey 07/05	Dry Whey 06/28	Change	Cheese 07/05	Cheese 06/28	Change
Jul-13	\$17.24	\$16.88	\$0.36	57.70¢	56.25¢	1.45¢	\$1.693	\$1.666	\$0.027
Aug-13	\$17.96	\$17.77	\$0.19	57.50¢	56.50¢	1.00¢	\$1.767	\$1.756	\$0.011
Sep-13	\$18.52	\$18.29	\$0.23	58.00¢	56.20¢	1.80¢	\$1.827	\$1.813	\$0.014
Oct-13	\$18.47	\$18.27	\$0.20	56.75¢	56.75¢	0.00¢	\$1.829	\$1.818	\$0.011
Nov-13	\$18.15	\$18.15	\$0.00	56.75¢	56.75¢	0.00¢	\$1.790	\$1.805	(\$0.015)
Dec-13	\$17.80	\$17.85	(\$0.05)	56.75¢	56.60¢	0.15¢	\$1.762	\$1.780	(\$0.018)
Jan-14	\$17.32	\$17.37	(\$0.05)	54.00¢	54.35¢	(0.35¢)	\$1.742	\$1.753	(\$0.011)
Feb-14	\$17.13	\$17.20	(\$0.07)	52.50¢	52.50¢	0.00¢	\$1.741	\$1.737	\$0.004
Mar-14	\$17.07	\$17.10	(\$0.03)	52.00¢	52.00¢	0.00¢	\$1.733	\$1.732	\$0.001
Apr-14	\$17.11	\$17.13	(\$0.02)	50.00¢	50.00¢	0.00¢	\$1.740	\$1.737	\$0.003
May-14	\$17.18	\$17.15	\$0.03	50.00¢	50.00¢	0.00¢	\$1.735	\$1.730	\$0.005
Jun-14	\$17.20	\$17.14	\$0.06	48.00¢	48.00¢	0.00¢	\$1.751	\$1.751	\$0.000
<b>12 Mo Avg</b>	<b>\$17.60</b>	<b>\$17.53</b>	<b>\$0.07</b>	<b>54.16¢</b>	<b>53.83¢</b>	<b>0.34¢</b>	<b>\$1.759</b>	<b>\$1.757</b>	<b>\$0.003</b>

- survey is finding that the percent rated poor or very poor is increasing. Irrigated hay land is doing OK so far, but parts of California are expecting that lack of water will impact production at the end of the season. Conditions are bad enough in AZ that some dairy producers have resorted to trying to hand spray some cows with water to attempt to make them more comfortable. The high in Phoenix was 119, but the real problem is that the low temperature is not dropping below 90. There is just no relief for the cows. Milk receipts are declining more rapidly now. NM conditions are being called close to seasonal. Milk is declining as expected. Cream markets have been improving for the past few weeks as ice cream plants have begun to take more cream.
- Fluid Milk Pacific Northwest: Daytime temperatures climbed into the 90's with some places reaching 100 degrees and above this week. The high temperatures are expected to stress milk cows and lower milk production. First crop harvesting of alfalfa is nearly finished with mixed results. Wet weather last week across much of the region lowered the overall quality of the first cutting. UT and ID also experienced temperatures nearing 100 degrees. The hot weather is expected to lower milk production in the region.
  - Butter: Heavy stocks of butter in cold storage are much of the driving force for lower prices. However, ice cream, cream cheese, sour cream, and dip manufacturers report their production is at seasonally high values for the week and taking much of the cream off the market. Butter demand is light into domestic sales, but a few plants are churning to meet contract quantities on 82% butter for the international market. Price rallies at the CME Group this week have traders and manufacturers trying to determine if the market has found firmer footing. The holiday shortened week will send additional milk supplies to butter/powder plants, but hot weather in the West could signal a significant slowdown in upcoming milk production.
  - CWT has accepted requests for export assistance to sell 665,796 pounds of butter and 2.361 million pounds of Cheddar, Gouda and Monterey Jack cheese. The product will be delivered July through December 2013.
  - NDM West: Western NDM prices continue to firm. Domestic sales are fair at expected levels. Export activity is good to very good with volumes sold increasing. Asking and sales prices are increasing on a weekly basis. Production of powder will be higher this week as more milk heads to manufacturing due to the holiday, but that fact will be short lived due to the intense heat in the region bringing milk production lower on a daily basis. High heat prices are increasing at a faster pace. Seasonal demand is improving. Stocks are very light.
  - Cheese West: Wholesale prices for Western cheese are lower as spot trading at the CME Group last week moved sharply lower. Prices had moved to levels not seen since mid-March. Heavy cheese stocks in storage are weighing on demand, but the higher spot prices this week increased interest from buyers hoping to catch the bottom of the market. Cheese production is steady this week, but recent hot weather in the West is expected to reduce milk supplies. Milk component levels are also declining. Stocks are currently not thought to be burdensome.
  - International: This week's GDT auction posted surprising strength in powders, pushing the overall dairy index up 0.7% vs. the prior event two weeks ago. Rennet Casin was up 7.9%, followed by butter milk powder up 6% and skim milk powder up 3.1%. Cheddar cheese fell 3.7% but is still priced at a U.S. equivalent \$1.99/lb.
  - International: Weather conditions in Western Europe have stabilized following periods of wet and hot weather. The relative levels of the milk supply are closer to year ago volumes. However, there is good internal demand for milk and dairy products. Demand for fresh milk and cream is strong. Relative high export pricing levels for finished dairy products are making the execution of exporting more difficult.

**What's Bearish:**

- Dairy Products Report: Cheddar cheese output in May was up a big 5.7% vs. a year ago and up 1.6% from April. Total cheese output rose 3.9% vs. May '12 and increased 2.6% from the prior month. That monthly total is also the highest May cheese production since 1982.
- Fluid Milk Northeast: Manufacturing milk supplies have increased in the Northeast and Mid-Atlantic regions, due to declines in Class I demand and various holiday related plant closures. Balancing plants are operating at near capacity levels in order to handle the increased volumes. Frequent rains over much of the Northeast and Mid-Atlantic region limited hay and hay silage harvest activities this past week, but a majority of crops in the two regions are in good to excellent condition going into July.
- Fluid Milk Southeast: Hot humid weather in Florida continues to lower cow comfort levels and milk production, but spot load exports increased this week to 88 loads (up 20 from last week) due to the upcoming holiday weekend. In addition, declining Class I demand has prompted the region to export loads to the Midwest. Additional auxiliary manufacturing plants were also called into production this week to handle the

increase in supplies. Demand for cream declined this week as a number of cream-based manufacturers shut down for all/or part of the holiday week. Cream supplies quickly exceeded demand and forced increased volumes to Class IV production.

- Fluid Milk Central: Central milk production in the northern tier of states is benefitting from a stretch of warm days and cool nights while West Texas dairy producers note decreases in milk production as the heat dome settled into that area. Availability of spot loads of milk is steady to higher for the week. Other plant managers with planned short production schedules for the week looked for opportunities to clear milk through the spot market. In addition, some milk loads from the East/Northeast stair-stepped into Central manufacturing facilities to alleviate continued strong milk intakes and some pushback from plants with equipment problems in that region. Milk loads from the East are clearing at some discounts, reportedly ranging to \$2 below Class.
- Dry Whey East: Dry whey production continues to be very active as strong off farm milk volumes are channeling heavy volumes to cheese plants. Current production is adding to inventories. Domestic demand remains lackluster with most buyers and end users willing to wait until after the holiday to assess and plan their future needs.
- Dry Whey Central: Dry whey production is modestly higher as manufacturing milk availability from Central region sources is steady to higher. Eastern handlers cleared milk into some Central region cheese plants to ease handling of milk in that region. Dry whey inventories are in balance to above immediate contract needs at a few plants.
- NDM East: Manufacturing milk supplies are very heavy this week, and as a result, condensed skim volumes going to dryers are heavy, increasing nonfat dry milk production. Most plants are operating at/or near capacity this holiday week. Export interest remains very active as this week's bullish SMP g/DT auction prices maintain nonfat dry milk as a lower priced alternative, but domestic and end user demand remains sluggish with most buyers waiting until after the holiday to resume business.
- NDM Central: With ready supply and limited upside risk, buyers are not anxious to own NDM above immediate needs. Central nonfat dry milk production is very active as some plants clear internal supplies as well as milk loads migrating into the region from Eastern sources. Nonfat dry milk inventories are steady to building.
- Cheese East: Milk volumes going to cheese plants continue to be strong with most plants operating at/or near capacity levels. Current production is adding to already expanded supplies. Hot and sometimes humid conditions have moved into the region and may begin to lower milk production and milk volumes going to cheese plants in the near future. Export demand remains fairly good, supported by export assistance programs.
- Cheese Midwest: Midwestern cheese plants are not short of milk. This week regional milk was supplemented by milk from the Northeast and East, which stair stepped west, bringing more milk into Midwest cheese plants this week. Some of the milk sold for at least \$2.00 under class price. Specialty cheese sales remain strong, especially Italian varieties. International interest for Midwest cheese is at a low level, according to some manufacturers. General retail demand remains lackluster.
- Grains: New crop corn put in new lows this week as improving crop conditions lessen the likelihood of a weather scare. At the time of writing, Dec corn was trading near the lows of \$4.91/bu. Beans also sagged lower, with the Nov contract near the session low of \$12.27½/bu.
- International: Australian milk production trends are flat at the start (July 1) of the new production season. Farmgate milk prices are higher with additional step up noted because of shifts in currency values and as processors match others' pricing. There is increasing farm level confidence for the new season. The New Zealand milk production season is projected to start well. Cows are in good condition. Conditions have improved for the pastures. Plentiful moisture since April has helped pasture stature and regrowth. Some areas have gone from drought to high moisture conditions.

#### Recommendation:

Despite being a holiday-shortened trading week, spot cheese prices saw decent trading and finished the week higher. The combination of the heat wave out West and stronger powder prices in this week's GDT auction most likely had bottom pickers thinking this was as good a time as any to acquire product. With only 4 trading days, cheese volume for the week was solid, with a combined 28 loads exchanging hands. With 3 of 4 weeks of the July Class III calculation all but done, upside for this contract will be limited from here. Aug - Oct, however, could see some real upside, depending on how severe milk production falls West of the Rockies. We're hearing quite a range but 8-10 lbs/cow drop appears pretty typical, for now. The bigger question will be how long will the heat last and will the cows rebound or lose even more production. If history is correct, rallies on heat waves usually get overdone and with producers having more experience dealing with heat, the cows often come back more than expected. The heat this year doesn't seem to be as intense as in '06 where dramatic death losses in the herd were realized. However, it will probably be enough to provide a short-term boost to prices. This is something hedgers should take advantage of, but don't expect new contract highs. With feed becoming ever cheaper, cost of production will drop and profitability will rise at lower milk prices. We would consider selling Aug in increments, starting at 18.50, Sep above 18.85 and Oct above 18.75. If we do get a decent rally in the weeks ahead, switch over to PUT options to protect these months. While our supply of short-term cheddar may tighten up and allow a rally in the near term, massive stocks still in storage, record-breaking cheese output in May, continued strong manufacturing milk supplies east of the Rockies and falling feed prices, probably means rallies should be sold through December. For those dairies receiving a decent premium above Class III, we would even suggest starting to get some light coverage in the first half of 2014. Jan-Jun '14 settled at an average \$17.17 today. Assuming about a \$2 premium would still put mailbox prices close to or over \$19.00/cwt. With feed prices dropping, it might not be a bad idea to get started on 2014 risk management early.

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