

The KDM Dairy Report – July 12th, 2013

What's Bullish:

- Fluid Milk Northeast: With humidity and many 90 degree readings in parts of Central and Eastern New York, milk production is showing signs of declining. New England milk components are dropping and production is beginning to decline. Following the long holiday weekend, more cream is going to ice cream and cream cheese production, less to butter. Cream cheese manufacturers have begun increased production aimed at filling fall orders. Reaching this time of summer coupled with hotter weather has resulted in higher ice cream production.

Futures Month	Class III 07/12	Class III 07/05	Change	Dry Whey 07/12	Dry Whey 07/05	Change	Cheese 07/12	Cheese 07/05	Change
Jul-13	\$17.36	\$17.24	\$0.12	57.88¢	57.70¢	0.17¢	\$1.709	\$1.693	\$0.016
Aug-13	\$17.65	\$17.96	(\$0.31)	57.00¢	57.50¢	(0.50¢)	\$1.740	\$1.767	(\$0.027)
Sep-13	\$18.32	\$18.52	(\$0.20)	58.80¢	58.00¢	0.80¢	\$1.801	\$1.827	(\$0.026)
Oct-13	\$18.31	\$18.47	(\$0.16)	57.78¢	56.75¢	1.03¢	\$1.812	\$1.829	(\$0.017)
Nov-13	\$18.10	\$18.15	(\$0.05)	57.50¢	56.75¢	0.75¢	\$1.785	\$1.790	(\$0.005)
Dec-13	\$17.72	\$17.80	(\$0.08)	56.75¢	56.75¢	0.00¢	\$1.751	\$1.762	(\$0.011)
Jan-14	\$17.20	\$17.32	(\$0.12)	55.38¢	54.00¢	1.38¢	\$1.741	\$1.742	(\$0.001)
Feb-14	\$17.10	\$17.13	(\$0.03)	52.50¢	52.50¢	0.00¢	\$1.739	\$1.741	(\$0.002)
Mar-14	\$17.10	\$17.07	\$0.03	51.75¢	52.00¢	(0.25¢)	\$1.736	\$1.733	\$0.003
Apr-14	\$17.13	\$17.11	\$0.02	51.00¢	50.00¢	1.00¢	\$1.740	\$1.740	\$0.000
May-14	\$17.22	\$17.18	\$0.04	50.00¢	50.00¢	0.00¢	\$1.758	\$1.735	\$0.023
Jun-14	\$17.25	\$17.20	\$0.05	48.00¢	48.00¢	0.00¢	\$1.770	\$1.751	\$0.019
12 Mo Avg	\$17.54	\$17.60	(\$0.06)	54.53¢	54.16¢	0.36¢	\$1.757	\$1.759	(\$0.002)

- Fluid Milk Southeast: Heat and humidity in the region has resulted in a lower level of dairy manufacturing, as milk needed to supply Class I demand is leaving less milk available for other classes. Milk shipments out of the region dropped to zero, down from 18 last week. Class I demand in Florida is normal for this time of year. Milk production is dropping but slower than expected. This is attributed to temperatures not having been as hot as normal. Temperatures are moving up this week so if that persists, expectations are for milk production to move lower and drying of cows to begin.
- Fluid Milk Central: Anecdotal reports from milk haulers indicate farm milk loads are decreasing in volumes as summer advances. Components within the farm milk are also dropping in step with the arrival of rising daytime temperatures and humidity. Spot milk loads are reportedly less available this week as manufacturing plants resume full production schedules post-holiday, but a few cheese plants obtained spot loads for the balance of July to allow for additional cheese production. Indications are that spot milk pricing is firming now, ranging from \$0.25 under Class to \$1.60 over. Cream supplies were uneven, with some tightness within the Central market at the beginning of the week as several ice cream plants restarted. A few churn operators indicated contract cream loads were shorted this week, as sales into Class II rebounded. The last week brought decent weather for some operators in small areas of the upper Midwest, allowing for finally taking first cutting hay, which is 4-6 weeks later than usual.
- Fluid Milk West: CA milk production has stabilized this week as temperatures are more moderate. Processing plants saw milk intakes down 8-15% during the height of the heat wave. AZ milk output continues to decline as a direct result of the hot weather conditions and the duration of the weather cycle. Heat abatement at the farm level is in place, yet struggling to mitigate the impact. The forecast of increasing humidity and the resulting "monsoon season" will likely foreshadow additional milk declines.
- Fluid Milk Pacific Northwest: Daytime temperatures continue in the 90's but are not as extreme as last week. Overall milk receipts are off as cows slowly recover. ID and UT production levels are lower from the recent hot weather. Some recovery is being noted as the extreme weather has abated. Milk supplies continue to be handled within the region as processors have adequate capacity for current production.
- Butter: In the Northeast, cream cheese manufacturers are already drawing cream to produce for fall orders and ice cream manufacturers have increased cream interest as hotter weather has arrived. These factors leave butter production down. Current bulk butter prices for this week are 4-6¢ over the market. Butter output in the Central region remains strong, but the rate of growth has slowed. Ice cream manufacturing is increasingly siphoning cream from the churns. Last week's 9¼¢ increase in CME prices surprised some manufacturers, not so much the fact of the increase, as the magnitude of the increase over one week. The hot weather across much of the West is causing concern over cream supplies. The hot weather is also making it difficult to move cream long distances. Although butter supplies in cold storage are adequate to heavy, buyers are looking to take advantage of current prices. Print butter sales into retail outlets remain good.
- Dry Whey: Prices strengthened this week in the Northeast. Some plants did not have spot sales product available this week, nor will it be available next week. Although there is less spot sale availability from plants, spot whey seems to be steadily available from brokers. The Central dry whey market is in balance. Dry whey production is steady to lower as plant managers report protein components in farm milk are declining seasonally, yielding less cheese and whey per hundredweight of milk. Also, some operations are sending more milk volumes into butter/powder production as returns from those products are expected to outpace commodity cheese returns in the near term. In the West, whey production remains mostly steady. Cheese plants continue to run busy schedules, but some are expressing concern over tighter expected milk supplies as hot weather affects milk production.
- NDM: The market undertone remains firm. Buying interest is light to fair from domestic accounts, fair to good into international markets. U.S. pricing and availability are favorable for international buyers. Pricing indices and the CME are trending higher. The pricing levels are creating some angst for buyers who were hoping for prices to be softer before they sought coverage. Drying schedules have been trending lower, reflecting the lower milk intakes caused by hot weather conditions.
- Cheese Northeast: A number of cheese manufacturers in the Northeast are operating 7 days a week. Some are acting on expectations of lower milk availability moving toward fall, thus building current stocks with an eye toward anticipated Fall sales. Recent cold storage facility expansions in the region by some manufacturers are still about half of capacity, leaving capacity to handle inventory. The fact of the new storage capacity also indicates some comfort in carrying higher inventory levels.
- Cheese Midwest: A number of cheese manufacturers in Wisconsin report that recent hotter weather resulted in milk components being down. Milk intakes are also generally down from last week. Some cheese plants have begun fortifying production with nonfat dry milk while others have not. In fact, some plants with production options are shifting milk away from cheese production into making butter or powder, motivated by expectations for better returns. Some manufacturers of process cheese have seen a bump in sales, attributed to summer grilling.

- Cheese West: Hot weather in the West is causing some concern as to upcoming milk supplies. Cheese demand remains steady, and buyers are hoping to increase inventories on price breaks.
- CWT has accepted requests for export assistance to sell 992,080 lbs of butter and 833,347 pounds of Cheddar and Monterey Jack cheese. The product will be delivered July through December 2013.
- Exports: The Foreign Ag Service reported that on a total-solids basis, May dairy exports were equivalent to 16.9% of U.S. milk production, the most ever (see graph). NDM exports totaled 123.4 million pounds, up 23% from a year ago. Volumes to Southeast Asia were up 60% vs. the prior year, and shipments to the Middle East/North Africa more than doubled. Cheese exports Jan-May are up 5% from 2012. Shipments to Mexico increased 10%, South Korea up 9%, Japan up 18% and Egypt up 185%. Whey exports are trending sharply higher, with May up 11% vs. April and the highest figure ever. China remains the major customer for U.S. whey products, with YTD purchases up 18% vs. 2012. Chinese imports of U.S. whey this year are currently 45% above year ago amounts.
- International: Dairy Australia reports May cheese production in Australia was down 3% vs. a year ago and butter output declined 25.4%. SMP production fell 8.5%, while WMP dipped 10.2% over the same period.



What's Bearish:

- Spot Market: Blocks gained a meager 1¢ on the week to settle at \$1.67½/lb, but barrels gave up 2¢ to close at \$1.65/lb. Sales were robust with 23 loads of blocks and 20 loads of barrels exchanging hands. Butter lost 6½¢ to settle at \$1.46/lb, but Grade A NDM picked up 1¢ to close at \$1.75/lb. 10 cars of butter exchanged hands and 6 loads of NDM.
- Weekly Cold Storage Holdings: Cheese stocks at USDA selected storage centers are up 2%, or 2.3 million lbs over the period 07/01 through 07/08. Butter stocks are up 5%, or 932,000 lbs over the same period.
- World Ag Supply & Demand Report: USDA lowered their 2014 Class III price forecast by 40¢/cwt from last month's report. They now expect Class III to average \$17.10/cwt for the year. Their outlook on 2014 milk production and exports are unchanged, but ending stock forecasts for cheese and butter have remained large, which they think will limit prices on those components in 2014.

Recommendation:

So far, the heat experienced out West and now in many other parts of the country appears to have had little impact in moving milk or cheese prices higher. Sellers in this week's spot market seemed more than willing to satisfy buyers as a solid 43 loads of cheese traded. There's no doubt the heat is making an impact. A look at the number of "bullish" vs. "bearish" points in this week's report bears that out. But we wouldn't get too fired up about that. It may be that the market is getting smarter. In years past, a heat wave like the one we just had would have seen prices shoot higher in a panic-driven rally. But more often than not, once the heat subsided, milk production would rebound to near pre-heat levels. It could be that the market has just shrugged its shoulders and carried on. With heavy inventories still weighing on the market, perhaps the market is correct. Or maybe it's not. International demand numbers are impressive. Despite what appears to have been a lull in May, demand might be picking up again. And certainly the heat is having a seasonal effect on manufacturing milk availability. The lone bright spot appears to be NDM. At \$1.75/lb, despite a weak butter market, Class IV calculates out to about \$19.30/cwt, while Class III, with cheese in the doldrums, sits at about \$17.00/cwt. We are seeing signs that milk is being channeled away from Class III and into Class IV, which is supportive of cheese prices. The volume of cheese traded in this week's spot market also indicates buyers are willing to own here. The next few weeks will be critical in regards to whether we'll see any kind of substantial rally in spot cheese, or not. Recall that the spec for spot cheese is young cheddar, aged 3-30 days. Despite the heavy inventories in storage, we could see a situation where the young cheddar supply might be impacted soon, if enough damage has been done by the heat. This might not be a long-lived rally however, if it happens at all. We would get ready to pounce on any substantial rally Aug-Dec and get additional coverage. Likewise, at an average base price of \$17.17/cwt for the first half of 2014, we would consider getting up to 20% of your milk sold at \$17.25 or higher. For those with \$2+ premiums, that's over \$19 mailbox for the first half of the year. Unless grain prices reverse their trend lower, this could be a very profitable level to sell. The bottom line is there is a high level of uncertainty out there now and predicting market direction is almost impossible. We may continue to trade milk in a sideways, range-bound pattern for quite a while.

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