

**The KDM Dairy Report – July 19<sup>th</sup>, 2013**

**What's Bullish:**

- Spot Market: Blocks finished the week 7¼¢ higher, settling at \$1.74¼/lb while barrels jumped 9¢ to close at \$1.74/lb. Trading was active with 13 loads of blocks and 18 loads of barrels exchanging hands. Butter closed the week 3¢ higher at \$1.49/lb on 8 trades and Grade A NDM gained 2½¢ to \$1.77½/lb on 3 trades.
- Cheese stocks at USDA selected storage centers have decreased 965,000 lbs, or 1% through the first 15 days of the month.
- Dairy cow slaughter for the week ended 07/06 totaled 47,200 head, up 5.4% or 2,900 head from the same period a year ago.

Futures Month	Class III 07/19	Class III 07/12	Change	Dry Whey 07/19	Dry Whey 07/12	Change	Cheese 07/19	Cheese 07/12	Change
Jul-13	\$17.38	\$17.36	\$0.02	57.73¢	57.88¢	(0.15¢)	\$1.713	\$1.709	\$0.004
Aug-13	\$18.26	\$17.65	\$0.61	58.78¢	57.00¢	1.78¢	\$1.792	\$1.740	\$0.052
Sep-13	\$19.04	\$18.32	\$0.72	62.00¢	58.80¢	3.20¢	\$1.862	\$1.801	\$0.061
Oct-13	\$19.00	\$18.31	\$0.69	61.98¢	57.78¢	4.20¢	\$1.854	\$1.812	\$0.042
Nov-13	\$18.45	\$18.10	\$0.35	60.50¢	57.50¢	3.00¢	\$1.805	\$1.785	\$0.020
Dec-13	\$17.86	\$17.72	\$0.14	59.98¢	56.75¢	3.23¢	\$1.760	\$1.751	\$0.009
Jan-14	\$17.30	\$17.20	\$0.10	55.28¢	55.38¢	(0.10¢)	\$1.721	\$1.741	(\$0.020)
Feb-14	\$17.12	\$17.10	\$0.02	52.50¢	52.50¢	0.00¢	\$1.720	\$1.739	(\$0.019)
Mar-14	\$17.09	\$17.10	(\$0.01)	51.75¢	51.75¢	0.00¢	\$1.730	\$1.736	(\$0.006)
Apr-14	\$17.10	\$17.13	(\$0.03)	51.00¢	51.00¢	0.00¢	\$1.735	\$1.740	(\$0.005)
May-14	\$17.19	\$17.22	(\$0.03)	50.00¢	50.00¢	0.00¢	\$1.750	\$1.758	(\$0.008)
Jun-14	\$17.22	\$17.25	(\$0.03)	48.00¢	48.00¢	0.00¢	\$1.760	\$1.770	(\$0.010)
<b>12 Mo Avg</b>	<b>\$17.75</b>	<b>\$17.54</b>	<b>\$0.21</b>	<b>55.79¢</b>	<b>54.53¢</b>	<b>1.26¢</b>	<b>\$1.767</b>	<b>\$1.757</b>	<b>\$0.010</b>

- At the Global Dairy Trade auction this week, the index of all dairy products increased 4.9% from the prior auction two weeks ago. WMP jumped 7.7% to a U.S.-equivalent \$2.29/lb, skim milk powder increased 3.3% to a U.S.-equivalent \$2.07/lb and cheddar cheese was up 2.1% to a U.S.-equivalent \$2.03/lb.
- Fluid Milk East: Balancing plant milk supplies are showing significant declines due to the combination of lower milk production and increased demand from Class II dairy manufacturers. Frequent rains have been replaced by hot, humid weather covering much of the Northeast and Mid-Atlantic regions. Though a majority of crop and pasture conditions are rated as good to excellent, there is increasing concern regarding the quality of the alfalfa and hay harvests. Wet field conditions over the past few weeks have delayed harvest activities and lowered the quality of the alfalfa and hay harvested. Florida milk production continues to decline as a number of producers are drying off cows, which is typical for this time of year. Exported spot loads were down to 42 loads this week with the anticipation that zero loads will be exported next week. Class I demand marginally increased, compared to last week. Hot humid weather in the Southeast region is reducing cow comfort levels and milk production. Supplies are nearly in balance with Class I demand, with only a few loads going to manufacturing facilities. Cream supplies are declining due to lower milk production and lower butterfat levels. Demand remains very active with strong pulls from ice cream and cream cheese manufacturers. Supplies are nearly in balance with need with very limited supplies going to Class IV production.
- Fluid Milk Central: Daytime temperatures in the mid to upper 90's blanketed the Central region this week. Milk production is decreasing in step with the high temperatures. Interest in spot loads of milk is higher for the week from Class III plants. Prices are reported as firmly in Class plus territory now, with prices for the week topping at \$2.00 over Class. Cheese manufacturers indicate butterfat and protein components are heading lower and affecting cheese vat yields. Butter/powder plant operators note the same changes in milk properties are affecting Class IV yields. Plant operators, though, are favoring NDM production over cheese due to perceived near to mid-term strength in the NDM markets. Cream availability is tighter for the week. Some churn operators continue to look for cream loads, but cream availability from the West/Mountain states is tighter. Corn acres are showing the effects of high daytime temperatures and lack of moisture. Observers note some leaves are curling on corn plants on high ground. Soybeans are also showing heat stress. Dairy operators in some areas are harvesting roadside grasses to supplement forage supplies.
- Fluid Milk West: CA milk production has flattened out and is closer to steady, but hot weather is expected to return late in the week. While the cooler temperatures made for more comfortable cows, milk production levels had little time to recover. Production decreases of 8-15% have been reported over the past few weeks. Tighter supplies of milk are causing milk to move to plants with best returns. AZ milk supplies are reduced due to hot weather, but supplies are adequate to maintain most production schedules. The beginning of the "monsoon" season has arrived and increased humidity levels are expected to hinder milk production. NM milk supplies are reduced but at expected levels. Increasingly humid weather has arrived and is making it more difficult to keep cows comfortable. Milk component levels are lower due to heat stress. Cream markets firmed this week as Class II plants are operating busy schedules. Cream supplies are reported to be tightening. The hot weather has made movement of cream more difficult if long distances are required.
- Fluid Milk Pacific Northwest: Milk production is mostly steady with recent weeks. Temperatures broke briefly, but hot weather is expected to return to much of the area. UT and ID temperatures were in the 90's with milk levels are steady to lower due to the warm weather. Component levels are lower due to the heat and reducing manufacturing efficiencies. Some canal companies are reported to be starting to shut water off in dry areas.
- Butter: Hot weather across the West is affecting both available milk supplies and butterfat levels. Cream multiples are steady to firm in the face of tighter supplies. Central butter production is steady at most locations this week, but Northeast butter production has declined due to a number of factors. Declining milk production, lower butterfat levels, increased Class II cream demand and seasonal maintenance on some churns have combined to significantly reduce butter production. Domestic demand for butter is steady for this time of year, but export interest remains fairly good with some butter makers continuing to fill 82% butter orders.
- Dry Whey Northeast: Prices moved higher again this week. The combination of declining milk supplies to cheese plants and increased condensed whey sales have lowered dry whey production. Dry whey supplies are readily available and domestic demand remains lackluster, but export demand continues to be active. The declining trend in dry whey production has given the market a steady to firm undertone.
- Dry Whey West: Hot weather is slowing milk production levels and more significantly lower milk component levels. Cheese plants are fortifying vats where possible, but prices of NDM are higher than desired. Whey drying has slowed as a result of tighter cheese manufacturing. Domestic demand is mostly steady, but export demand is good with much of the Western whey finding its path to the ports.

- NDM East: Prices moved higher this week. Lower milk production and increased demand for condensed skim from Class II users have pulled milk volumes away from dryers and lowered nonfat dry milk production. This week's firm g/DT auction results and declining milk supplies were the major factors contributing to the market's strength. Demand has improved as a number of buyers were prompted to expand inventories ahead of declining production schedules. The market undertone is firm.
- NDM Central: The market tone is firming. Brokers and traders note some concern is emerging regarding near term spot market availability. There is a short window of opportunity in the next few weeks for manufacturers to build up nonfat dry milk inventories for contract fulfillment. However, the recent bout of 90 plus daytime temperatures has decreased farm milk production and manufacturing milk availability. In addition, the build-up in Class I orders is anticipated in mid-August as educational institutions place bottled milk orders for cafeterias. Nonfat dry milk production is ongoing throughout the Central region, but below capacity at most locations.
- NDM West: Various pricing indices and strong export demand are helping to keep prices at a strong level. Demand is fair to good from domestic accounts. Buyers are able to fill contracted amounts, but additional product is harder to source. International demand is very good with U.S. sourced SMP helping to fill that demand. Increased production of SMP is limiting NDM production for domestic accounts. Interest in third and fourth quarter supplies is increasing. Hot weather in the West has negatively affected milk supplies and drying schedules are reduced.
- Cheese East: Cheese production is mixed in the region with some declines in production due to the downturn in off farm milk production. Cheddar cheese sales remain good, while mozzarella sales have slowed. Most cheese makers in the region are comfortable with their current inventories.
- Cheese Midwest: Whether Midwest heat in the 90's with high humidity stays for long, it is here now and cows are suffering. Milk production is dropping, as are components. Milk is not in short supply for cheesemakers but supplies are tighter. Spot milk prices are moving up, now up to about \$2.00 over class. There were reports of more buyers for cheese as last week progressed. Cheese manufacturers reported that a number of buyers who had held back, began to act on the expectation that cheese prices were likely to trend up as summer progressed.
- CWT has accepted requests for export assistance to sell 3.522 million lbs of butter and 4.398 million lbs of Cheddar and Monterey Jack cheese. The product will be delivered July through December 2013.
- International: Australian milk output is near the seasonal low point. Early estimates are for a fair to good start to the new season, but some stress issues are still noted from last year's drought. Some reports are coming in of cattle that didn't settle because of all the stress they were under last year. New Zealand is still experiencing issues related to the drought at the end of the last production season. Feed and forage prices are very high as milk producers were forced to use winter feed stocks much earlier than normal with no real replacements at hand. Moisture conditions have improved greatly, but conditions are too cold for any pasture use at this time with any real feed value. Supplies of dairy products are currently light, just before the real start of the new production season.

#### What's Bearish:

- Milk Production Report: Milk output in June was up 1.5%, according to figures released by USDA today. This is on the high end of most analysts' expectations. Largest percentage increases were seen by KS up 9.4%, IN up 5.8%, IA up 4.5% and CO up 4.1%. WI was up just 1.8% and CA was down 0.8%.
- Livestock, Dairy & Poultry Outlook Report: USDA lowered its 2014 Class III price forecast 40c/cwt from last month, on weaker expectations for cheese prices. Higher stocks of cheese at the end of this year will carry over into next year and will likely pressure prices. Class III is now expected to average \$17.10/cwt in 2014.
- Dry Whey Central: Prices were steady this week. Per some market participants, the Central dry whey market is comatose. Dry whey is available within the region from some manufacturers and resellers and domestic buyers are reportedly not feeling any urgency to take positions at this time. Export markets are providing some outlet for Central contract and spot loads. Various cheese manufacturers report protein components in milk are registering steady decreases as the daytime temperatures increase. This is decreasing cheese and dry whey output for the near term.
- International: Milk output is declining along seasonal expectations in Western Europe, but weather is not a real factor now in hastening the decline. Some countries, especially France, seem to be bouncing back quite well. Feed supplies are better and margins are improving with better prices for milk. Other countries are also narrowing the gap caused by the inclement spring weather. Pasture and forage growth are positive for this season.

#### Recommendation:

Sustained heat that spread over much of the country is finally putting a dent in milk production. Although temps across the Midwest have now moderated and relief is coming to the Northeast, our sources indicated several plants in these regions were short on milk. It remains to be seen, however, what the impact will be in the long run. Modern operations with fans and misters were generally down just 3-5 lbs/cow while other operations suffered losses in the 8-10 lb range. Feed quality may also play a role in how well cows bounce back, as rain out East has delayed 2<sup>nd</sup> cuttings and alfalfa remains tight in the Midwest. More heat, though not as severe, is expected in the West next week. Despite a bearish Milk Production Report for June, those waiting for a bottom in the spot market decided to get busy. Who cares about June output when July production is taking a hit now? Sellers seemed content to satisfy buyers through midweek, but when bids became even more aggressive, offers were higher and sales fewer. In our estimation, the rally in Class III this week is a gift for producers to get some coverage at higher levels. We're not convinced the heat was here long enough to do sustained damage, so unless we see another heat wave or a big uptick in demand, this rally could be somewhat short lived. Don't get us wrong, it will most likely benefit the Aug-Oct contracts, but we believe rallies in the Sep-Dec contracts should be sold. That said, the uptick in this week's GDT auction for both powder and cheese could help sustain higher prices. International demand for powder appears solid, while dry whey is getting tighter as a result of lower cheese output. Hang on for what could be a volatile ride over the next few weeks. As we said earlier, hedgers should consider selling some of their production Sep-Dec. Consider the following target prices: Sep @ \$19.25, Oct @ \$19.19, Nov @ \$18.53 and Dec @ \$18.25.

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