

The KDM Dairy Report – August 16th, 2013

What's Bullish:

- Weekly cold storage holdings numbers indicate a typical seasonal drawdown so far in August. For the period 08/01 through 08/12, cheese stocks at USDA selected warehouses were down 2%, or 1.7 million lbs, while butter stocks declined 9%, or 1.6 million lbs.
- Class III component prices continued to rise in this week's National Dairy Product Sales Report, in response to recent strength in the spot market. 40-lb block cheddar averaged \$1.73/lb, up 1.5¢ from last week, while 500-lb barrels increased 3.2¢ to average \$1.77/lb. Butter gained 1¢ to average \$1.45/lb and NDM inched 0.6¢ higher to \$1.77/lb, but dry whey decreased 0.9¢ to average 57.4¢/lb.
- Dairy cow slaughter for the week ended 08/03 totaled 60,700 head, the highest number in 14 weeks. It was also 1,700 head higher than the same period a year ago.

Futures Month	Class III 08/16	Class III 08/09	Change	Dry Whey 08/16	Dry Whey 08/09	Change	Cheese 08/16	Cheese 08/09	Change
Aug-13	\$18.05	\$18.09	(\$0.04)	58.00¢	58.03¢	(0.02¢)	\$1.779	\$1.784	(\$0.005)
Sep-13	\$18.23	\$18.05	\$0.18	58.05¢	58.50¢	(0.45¢)	\$1.797	\$1.780	\$0.017
Oct-13	\$18.23	\$17.96	\$0.27	58.00¢	58.00¢	0.00¢	\$1.800	\$1.773	\$0.027
Nov-13	\$17.60	\$17.55	\$0.05	58.25¢	58.50¢	(0.25¢)	\$1.732	\$1.729	\$0.003
Dec-13	\$16.95	\$16.91	\$0.04	58.00¢	57.50¢	0.50¢	\$1.673	\$1.681	(\$0.008)
Jan-14	\$16.41	\$16.41	\$0.00	54.50¢	54.85¢	(0.35¢)	\$1.636	\$1.642	(\$0.006)
Feb-14	\$16.21	\$16.35	(\$0.14)	53.38¢	54.10¢	(0.73¢)	\$1.635	\$1.641	(\$0.006)
Mar-14	\$16.19	\$16.44	(\$0.25)	52.28¢	53.00¢	(0.73¢)	\$1.627	\$1.655	(\$0.028)
Apr-14	\$16.11	\$16.43	(\$0.32)	52.00¢	52.98¢	(0.98¢)	\$1.625	\$1.655	(\$0.030)
May-14	\$16.26	\$16.52	(\$0.26)	52.00¢	53.00¢	(1.00¢)	\$1.640	\$1.664	(\$0.024)
Jun-14	\$16.44	\$16.65	(\$0.21)	52.00¢	53.00¢	(1.00¢)	\$1.655	\$1.696	(\$0.041)
Jul-14	\$16.79	\$16.96	(\$0.17)	49.00¢	50.00¢	(1.00¢)	\$1.710	\$1.725	(\$0.015)
12 Mo Avg	\$16.96	\$17.03	(\$0.07)	54.62¢	55.12¢	(0.50¢)	\$1.692	\$1.702	(\$0.010)

- Fluid Milk Southeast: The milk situation has now "flipped", with supplies being lower while fluid demand is increasing. Many schools have started again and schools in Missouri and Arkansas begin classes next week. No shipments into the region were noted this week but that is expected to change next week, with seasonal imports beginning. Florida Class I milk demand is up with schools starting for the season. Milk imports increased from 28 loads last week to 73 loads this week. Farm milk production is observed to be dropping like a rock by one plant official. Producers are starting to dry cows and the weather is not good for cow comfort. Daily temperatures reach 96 degrees with heat indexes of 105, dropping only to 78 at night.
- Fluid Milk Southwest: Conditions in NM have cooled off somewhat due to rain showers, but that has raised the humidity levels. The call for school milk is increasing, somewhat limiting the volumes left for manufacturing.
- Fluid Milk Pacific Northwest: Milk production is following expected seasonal declines. Temperatures along the coastal regions are moderate, while the High Desert regions continue to see hot, dry weather in the 90's. Milk is being handled within the region and plants are taking advantage of lower volumes to perform maintenance duties. UT and ID milk production is steady, but production capacity exceeds current milk supplies.
- CWT has accepted requests for export assistance to sell 1.682 million lbs of butter and 2.698 million lbs of Cheddar, Gouda and Monterey Jack cheese to customers in Asia, Europe, the Middle East and North Africa. The product will be delivered August 2013 through January 2014.
- Dry Whey East: Prices strengthened slightly this week. Some whey was sold on spot markets by some manufacturers who have not recently made spot market offerings, but brokers appeared ready to absorb the manufacturers' available spot whey, to hold for future sale.
- NDM East: Prices advanced this week, as there was a reduction in drying volume in some regional plants. With school pipeline fluid milk draws in the Northeast soon to begin, plant operators expect drying schedules are more likely to be further reduced than increased in coming weeks.
- NDM Central: Prices in the Central region are steady to firm as demand remains very good. NDM production is lower as milk volumes in the Midwest adjust seasonally lower and component levels return slowly from the midsummer heat. Demand for export SMP is good with manufacturers taking advantage of tight world supplies. Production and supplies of NDM are reduced as some milk and condensed skim is steered to the international marketplace. Condensed skim supplies are becoming limited as more milk begins to enter the Class I pipeline for the new school season.
- NDM West: The market continues to be firm with prices moving higher. Export sales continue to drive the market. Domestic interest is fair for normal, seasonal needs. Manufacturers have some powder available for sale, but it is often for limited volumes. Producers are moving good volumes of NDM and SMP into export channels. The SMP production for exporting also continues to limit the amount of NDM available for domestic use.
- Cheese Midwest: Demand for Mozzarella and Provolone, described as booming.
- Cheese West: Cheese sales remain good with inventories higher than year ago, but considered to be manageable. Cheese manufacturers are running busy schedules to take advantage of firm prices. Export sales continue to aid in clearing inventories in cold storage.
- Grains: A reduction in yield forecasts combined with continued dry weather in the Midwest gave grains a boost this week. Dec corn settled at \$4.63/bu, 17¼¢ above the low it put in earlier in the week. Beans were more impressive, with the November contract settling at \$12.59/bu, 76¼¢ higher than its low.
- International: Milk production trends in Western Europe are declining seasonally and levels in most countries are trailing year ago levels. The lingering effects of hot weather conditions are impacting milk output. Pricing levels are higher for SMP, WMP, and whey. The stronger Euro values continue to make exporting prices higher. Butter prices remain at high levels and continue to restrict exporting. Demand for cream is good and pricing levels are high. Milk production in Eastern Europe is reported to be lower than year ago levels. Declines are noted in Poland, Czech Republic and most other countries. The delay in the season start and recent hot conditions have had an adverse effect on the milk supply. Processing plants are running on reduced schedules.

What's Bearish:

- Spot Market: Blocks finished the week down 2¢ to settle at \$1.77¼/lb while barrels were unchanged at \$1.76½/lb. Just 5 loads of blocks exchanged hands, all on Friday, while there were no sales in barrels all week. NDM closed unchanged at \$1.75/lb on no activity, and butter shed 2¼¢ to settle at \$1.37/lb on just 2 trades.
- Fluid Milk Northeast: Northeast milk supplies are comfortable related to demand and production. Schools are still a couple of weeks from beginning the milk pipeline filling process. Recent temperatures in the 60's during the days keep cows comfortable. Corn and soybeans are in great shape and seem to be the best crop in many years. Yields and quality for corn and soybeans are expected to be high as both crops have received rain and the right temperatures at the optimum times of growth. Maryland and Delaware hay supplies are rated mostly adequate. Pasture conditions are rated fair to good in both states.
- Fluid Milk Central: Milk supplies in the Midwest are adequate. Cream demand is softening in the region as cream cheese and ice cream demand is lackluster. Butter churns are taking up much of that slack, but are cautious over price. Midweek cream multiples were lower as cream backed up to some manufacturers. Cooler temperatures in the Midwest increased cow comfort levels. Crops in the Midwest are generally in good condition.
- Fluid Milk West: Conditions are much improved for milk production in CA. Days are still warm, but nights are cooling enough to give the milking herd some real relief. Contacts indicate that they have seen a good rebound in milk output. Hay and corn silage production are good and allowing producers to increase feeding rates. AZ weather has moderated some, though humidity levels are higher. There was enough rain last week to be beneficial to some crops. The alfalfa crop is in good condition. Milk supplies are up a bit.
- Butter Northeast: Butter demand is flat and inventories are burdensome at some production facilities.
- Butter Central: Butter inventory levels are burdensome in the estimation of some Central butter manufacturers. Some cream sellers report a noticeable reduction in cream orders this week from ice cream manufacturers. The decline in international butter prices following last week's GDT auction is likely to signal more weakness for U.S. butter prices. Unless orders are in hand, most manufacturers are very reluctant to churn butter for inventory purposes.
- Butter West: Though retail sales into grocery accounts and club stores remain good, heavy stocks of butter in cold storage continue to weigh on prices. Buyers are aware of the heavy inventories and falling prices so are only willing to marginally order ahead, or wait to see next week's price.
- Dry Whey Central: Demand is spotty, with buyers looking for lower prices to make purchases. Increased seasonal demand is expected, but buyers are finding supplies of whey available from both manufacturers and brokers. Increased cheese production in the region has increased inventories and brokers are looking to lower their holdings.
- Dry Whey West: Prices are steady to weak. Whey production is steady as cheese plants continue to run busy schedules. Demand for whey is moderate with price being the determinate factor. Whey inventories are adequate with supplies available at both the manufacturers and brokers.
- Cheese East: With concern over filling the school milk pipeline still a couple of weeks ahead, pleasant weather has contributed to milk supplies at a comfortable level. Coupled with the fluid milk demand situation not yet tightening to meet school demand, this leaves some milk readily available for expanding cheese production schedules.
- During June, 3.9 billion lbs of packaged fluid milk products are estimated to have been sold in the United States. This was 5.9% lower than June 2012. Estimated sales of total conventional fluid milk products decreased 6.4% from June 2012.
- International: Australian milk production is holding mostly steady to slightly higher. Producers are poised to begin the seasonal start well. Cows are generally in good condition, the new season grain crops are on track, pasture health is rated good, milk prices are favorably positioned, and farm financials have improved. Weather conditions are currently favorable. New Zealand milk production is idling in low gear ahead of the anticipated growth as the new season begins. Rains were recorded over the last weekend and pasture conditions are ranked as near normal to above normal across the dairy regions. Feed conditions are adequate to good ahead of the seasonal growth.

Recommendation:

It was another interesting week. The spot market was mainly quiet, which, being the main driver of Class III futures, usually means a quiet week in the milk trade. However, we continued to see what we guess is producer selling of the 2014 contracts as concern grows over declining feed costs, increased milk production potential and worry over international demand. While most of the 2013 contracts finished the week higher, the 2014 contracts were in the red. The first half of the year was hit particularly hard with double-digit losses. It appeared at times there was a lack of liquidity in some of the months further out as just 1-2 trades would knock prices down 15-20¢. Current spot prices work out to about \$18.00 Class III and \$19.30 Class IV. Some schools have already opened, with the rest over the coming weeks. This may give us what we'd call a "mild rally" as fluid demand digs into manufacturing milk supply, but butter and cheese stocks will most likely limit the upside. Powder is tight worldwide, which is supporting NDM prices, but butter is very weak on the supply glut. It's very likely we could sit between \$17 and \$19 Class III for the balance of the year. Going into 2014, however, we continue to have a negative outlook, despite these contracts now looking oversold. Jan-Jun avg is \$16.29 with all of 2014 avg at \$16.59. If your operation can profit at these numbers, we would consider some sales on any light rallies, say 5-10¢ higher. With the U.S. exporting an equivalent of 16.5% of its milk production Jan-Jun, our milk prices are now very susceptible to global demand. It's great when demand/exports keep rising, but there will be blips along the way and those could cause major price meltdowns. Just a 2% drop in international demand would cause a domestic milk glut and bring prices sharply lower. Even the current mess in Egypt, should the conflict expand, could put dynamic forces into play in the energy and food sectors. The bottom line is, there's a lot of uncertainty and no one knows where the markets are going. But there's also enough risk, that locking in some profitability in Q4 and well into 2014 makes some sense.

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