

**The KDM Dairy Report – September 13<sup>th</sup>, 2013**

**What's Bullish:**

- Spot Market: Cheese buyers pushed the block price up 3¢ this week to \$1.84/lb, picking up 14 loads in the process. Barrels gained 1¼¢ to \$1.81¼/lb on just 2 trades. NDM increased 1½¢ to \$1.83/lb on 3 trades, while butter buyers went on a rampage, snapping up 47 loads and raising the price 9¢ to \$1.53/lb.
- Fluid Milk East: From New England to the Mid-Atlantic states, milk supplies are very tight this week. Unexpectedly so. Some New England plants are short of sufficient milk to fill this week's contracts for condensed skim. The milk supply tightness doesn't fit into seasonal expectations of some plant managers. Unusually hot weather is a factor.

Futures Month	Class III 09/13	Class III 09/06	Change	Dry Whey 09/13	Dry Whey 09/06	Change	Cheese 09/13	Cheese 09/06	Change
Sep-13	\$18.18	\$18.06	\$0.12	57.70¢	58.25¢	(0.55¢)	\$1.800	\$1.787	\$0.013
Oct-13	\$18.19	\$17.86	\$0.33	57.75¢	57.88¢	(0.13¢)	\$1.801	\$1.766	\$0.035
Nov-13	\$17.78	\$17.37	\$0.41	57.20¢	57.50¢	(0.30¢)	\$1.753	\$1.719	\$0.034
Dec-13	\$17.05	\$16.83	\$0.22	57.63¢	57.50¢	0.13¢	\$1.676	\$1.655	\$0.021
Jan-14	\$16.56	\$16.56	\$0.00	54.50¢	54.25¢	0.25¢	\$1.652	\$1.662	(\$0.010)
Feb-14	\$16.41	\$16.46	(\$0.05)	53.50¢	53.10¢	0.40¢	\$1.647	\$1.660	(\$0.013)
Mar-14	\$16.37	\$16.53	(\$0.16)	53.00¢	52.75¢	0.25¢	\$1.652	\$1.662	(\$0.010)
Apr-14	\$16.39	\$16.47	(\$0.08)	52.00¢	51.25¢	0.75¢	\$1.652	\$1.675	(\$0.023)
May-14	\$16.39	\$16.48	(\$0.09)	52.00¢	50.50¢	1.50¢	\$1.655	\$1.672	(\$0.017)
Jun-14	\$16.67	\$16.72	(\$0.05)	52.00¢	50.50¢	1.50¢	\$1.690	\$1.706	(\$0.016)
Jul-14	\$16.95	\$17.00	(\$0.05)	49.00¢	49.50¢	(0.50¢)	\$1.740	\$1.740	\$0.000
Aug-14	\$17.07	\$17.11	(\$0.04)	48.25¢	49.00¢	(0.75¢)	\$1.745	\$1.740	\$0.005
<b>12 Mo Avg</b>	<b>\$17.00</b>	<b>\$16.95</b>	<b>\$0.05</b>	<b>53.71¢</b>	<b>53.50¢</b>	<b>0.21¢</b>	<b>\$1.705</b>	<b>\$1.704</b>	<b>\$0.002</b>

Very busy schedules in the Northeast plant location of a national yogurt brand, is a factor also cited for taking large milk draws. A New York state cheese plant manager had to reduce schedules due to milk supply tightness. In the Mid-Atlantic states, some plants are screaming for milk. Part of the reason is post Labor Day plant orders being higher than expected, with some stores having reduced fluid milk orders before the holiday weekend, apparently underestimated demand, so now they are trying to get inventories to a more comfortable level. Southeast milk supplies seem to be in better balance. Calls are being received in that region seeking milk to go to the Northeast. Florida slightly increased milk imports to 186 this week from 180 last week and 90 more than a year ago. Production on the farm is still on a downward spiral but at a slower pace. Continuing declines are expected to continue for several more weeks. Condensed skim milk supplies have tightened even more than last week due to the reduced milk supply. Some contracts will not be filled on schedule as a result.

- Fluid Milk Central: Farm milk intakes stepped lower this week at several milk handling locations as a result of recent high daytime temperatures and decreases in cow comfort resulting from those increased temperatures. Milk marketers indicate there are no spot loads available in the region, but interest is active. Cheese manufacturers report orders are increasing, but right now, manufacturing milk availability is tight and they unable to adequately increase cheese production to fulfill increasing orders. Milk marketers indicate demand from bottlers is strong. The last of the school pipeline is filling and Class I demand is expected to settle into the fall pattern that includes furnishing milk into education institutions as well as supplying more milk for family meal times at home and in restaurants. A few butter manufacturers noted finding cream was difficult and searches for loads often ended without success. Most cream buyers relate this recent shortage to cream cheese producers receiving a higher number of contract cream loads as their new production season ramps up. Also, soft serve manufacturers are still active and drawing upon cream supplies in the region.
- Fluid Milk West: CA milk production was lower as hot weather continued across much of the state. Cooler nights have helped but the hot summer has taken a toll on cows and production. Monsoon rains in southern California have also hurt production as dairies deal with muddy conditions. Plants have been running at reduced schedules where milk is tightest. AZ milk production is lower as monsoon rains covered much of the state and caused some local flooding. Processors report milk intakes at "rock bottom" for the season with more rain predicted. Dairies report muddy yards are adding to lower milk yields. Increased demand from Class I handlers was also credited with tightening available milk. Processors were scrambling to find milk so that they could fill contracted product demand. Effects on NM milk production were less of an issue as rains were lighter, but temperatures were above normal for the week and added to dairy cow stress. Class I demand continued to pull available manufacturing milk away from processors. Cream demand is stronger from butter churns as print butter demand increases for the fall. Good export demand and increased print orders have churns operating busy schedules.
- Fluid Milk Pacific Northwest: Milk production in the region was lower this week. Increased pulls from Class I demand also served to tighten manufacturing supplies. UT and ID milk production is seasonally lower. Processors are arranging production schedules to fit the tighter milk supplies.
- Butter: Western churns are busy filling orders but Central and Northeast churns are not able to run at capacity. Central spot cream availability is hampering reaching full production. Prices are firming as seasonal demand is reported to be good. Retail orders for print butter are very good with buyers often looking to increase contracted amounts. Brisk sales into club store accounts combined with supermarket orders are keeping churns busy filling orders. Current prices are well below year ago levels and add to the demand. Export demand is also strong. Export sales are up as U.S. prices are very competitive into international markets. Butter stocks that had been thought to be heavy are clearing into the market. Bulk butter sales are good with discounts becoming less common.
- NDM East: Milk supplies are tighter and NDM prices are increasing in the region. The lack of available milk led some plants to not operate dryers this week. Few expressed certainty for next week's scheduling due to the tight milk supply situation.
- NDM Central: Prices shifted higher in step with various contract indices that increased last week. Manufacturers' offers to the spot market are limited as they reevaluate current stocks and finalize projections for the balance of the year. Low/medium and high heat production is greatly reduced according to plant operators. This is a result of decreasing milk intakes at several plants, as well as increasing opportunities to sell condensed skim spot loads at improved prices.
- NDM West: Prices are higher this week as milk supplies for manufacturing in the West are tightening and plants are reporting tight supplies. The hot weather combined with increased pulls from Class I demand have reduced intakes and manufacturers are having a hard time building inventories. Export sales of SMP continue to be very good and adding to a lower volume of NDM for the domestic marketplace. The market has a firm undertone due to the tight supplies. Interest in contracting for 2014 is picking up as end users look to assure supplies for next year.

- Cheese East: Cheese plants in the Northeast have experienced tighter milk supplies than anticipated this week. Reasons advanced vary, but most often suggested are both the unusually hot weather which reduced milk production, as well as an apparent increase in regional yogurt production by a national brand. A cheese plant manager said that yogurt is "sucking up all the extra milk" that can be found. The milk supply situation has led to some cheese vat production scheduling reductions.
- Cheese Midwest: Many cheese manufacturers report that milk supplies have become tighter. This leads to lower production than some plants would prefer. In fact, some plants are scrambling to purchase cheese on the CME to fill orders. Other plants which have been fortifying vats with nonfat dry milk plan to stop this soon due to the price of NDM. Further challenging managers in accommodating customers, some retailers have not only increased orders, but some now want previously canceled orders filled.
- Cheese West: The market tone is firm as holiday buying orders are being placed. Hot weather across much of the West has tightened milk supplies and less milk is available for cheese production. Plants are increasingly turning to shorter production schedules rather than competing for spot loads of milk. Export demand is being aided with assistance from the CWT program again this week. This week saw requests for assistance with 8.2 million pounds of cheese being accepted.
- Exports: Dairy exporters shipped 178,101 tons of milk powder, cheese, butterfat, whey and lactose during July, up 32% from the prior year, according to the U.S. Dairy Export Council. In the first seven months of 2013, exports were higher among all major product categories and to all major markets. Nonfat dry milk/skim milk powder (NDM/SMP) exports were up 16% in the January-July period, led hefty gains (+40%) in sales to Southeast Asia. Sales to the Philippines (+24%), Indonesia (+53%) and Malaysia (+115%) have increased significantly. In addition, U.S. suppliers more than doubled their sales to China and more than tripled their sales to Algeria. Cheese exports in July were 27,297 tons, +22% from last year, led by a 56% gain in sales to Mexico. Butterfat exports were 8,743 tons in July, +166% vs. a year ago and the most in nearly five years. In July, the United States exported 67% of the NDM/SMP produced, 6.6% of the cheese and 14.4% of the butterfat. On a total-solids basis, exports were equivalent to 17.6% of U.S. milk production in July, a new record high.
- International: Rabobank dairy analysts were quoted in an article this week forecasting the Indian dairy market to grow strongly this decade, with an annual growth of an astonishing 13%-15%, until fiscal 2020. The study by Rabobank said growth will be driven by increasing consumption of value-added products as well improvements in the value chain.
- International: Glanbia Ingredients Ireland announced a new record high pay price for August milk supplies. Supplies are still tight and stocks are limited and committed.
- International: Milk production trends are steady to seasonally lower in Western Europe. Good demand for fresh products is pulling milk out of manufactured production. Cream demand remains good and some processors are selling cream instead of making butter. There is active demand for fresh, cream based products. Buyers are seeking coverage for both near term and fourth quarter needs. Offerings and stocks remain mostly light.
- International: Oceania cheese prices are unchanged, at about \$2.02/lb U.S. equivalent. Production trends are limited with any new milk moving to other products. Output is expected to ramp up slowly. World demand is fair, but U.S. pricing is positioned to capture price driven demand. The limited production has also held stocks in check. Cheese holdings are light and mainly adequate for current trade needs.

#### What's Bearish:

- Dry Whey: Northeast dry whey prices were slightly higher this week, but the market is looking for direction. Most brokers are taking contracted loads and inventories are increasing a bit. Prices in the Central region retreated this week and spot load prices from manufacturers were slightly lower on a weaker market. Buyers indicate dry whey is readily available in the Central region from a few manufacturers and several resellers. Western dry whey prices were lower across the range. Spot sales this week were light, while supplies remain adequate for the marketplace.
- International: Australian milk production is steady to higher with levels generally around year ago marks. The temperatures have been warm with adequate moisture for pasture and crop growth. Conditions are favorable for the start of the new season milk. Cows are in good condition coming off the winter season. Milk price pay prices are increasing, which is welcome news to dairy farmers. Dairy Australia's forecast is for milk production growth of 1-3% for the 2013/14 season. The milk production season is ramping higher in New Zealand. More cows are calving and entering the milking string. Milk processing is building and more plants are coming on line and seeing milk intakes. Early season indications are that milk is tracking at or slightly higher than year ago levels.

#### Recommendation:

Wow, what a week! Last Friday we were scratching our heads, wondering why Class III futures were pricing a discount to the spot market. This week the spot market made a strong move higher in all components (block and barrel cheese, NDM, butter) and futures finally responded. With demand season now in high gear, the U.S. suddenly finds itself in a tight fresh milk situation from coast to coast. Yogurt output in NY is snapping up supplies while heat out West has put a crimp on milk receipts. Some cheese plants in the Midwest are resorting to buying at the Merc to fill orders, which have suddenly come out of the woodwork. Despite perceived large supplies of cheese in the warehouse, prices have steadily ticked higher over the past couple weeks. Buyers are now suddenly realizing they may have missed the bottom and are scrambling to buy before prices rise any higher. But cheese wasn't the only mover this week as NDM and butter were both solidly higher during spot trading. The 9¢ surge in butter was sent Class IV to about \$20.30, while Class III sits at about \$18.60. October settled at \$18.19 today, up 33 for the week and exactly where it was two weeks ago. Nov finished the week up 41 to \$17.78. With holiday ordering just gathering steam, both of these contracts, and even Dec, should benefit over the coming weeks. But the dairy market as fickle. As quickly as our current "tight" situation has risen, it can disappear. The close we get to \$1.90 cheese, the more resistance there will be and the less interested buyers will become; at least in our opinion. For that reason, we would stick with those hedge targets for Oct-Dec (Oct upper \$18's, Nov upper \$17's to low \$18's, Dec mid \$17's). The Jan-Jun 2014 avg gave up 7¢ to settle at \$16.47. If Q4 prices keep rising, it will send a signal to make more milk. We'd still be patient here, but would keep that \$16.70 avg as a target, selling up to 25% of your milk. Volatility looks set to increase over the coming weeks, so best to get your orders in and working so they can hit!

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