

The KDM Dairy Report – September 27th, 2013

What's Bullish:

- All Class III pricing components were higher in this week's Dairy Products Sales Report. 40-lb block cheddar increased 3.3¢ from last week to average \$1.78/lb and 500-lb barrels were up 2.9¢ to \$1.82/lb. Butter gained 3.1¢ to average \$1.43/lb, dry whey inched 0.7¢ higher to 58.2¢/lb and NDM increased 1.1¢ to average \$1.81/lb.
- Butter stocks in cold storage at USDA selected storage centers decreased 8%, or 1.2 million lbs over the period 09/01 through 09/23.
- 65,900 dairy cows were removed from the herd during the week ended 09/14, up 3.9% vs. the same period a year ago, and the highest weekly total since March.

Futures Month	Class III 09/27	Class III 09/20	Change	Dry Whey 09/27	Dry Whey 09/20	Change	Cheese 09/27	Cheese 09/20	Change
Sep-13	\$18.13	\$18.14	(\$0.01)	58.25¢	57.60¢	0.65¢	\$1.791	\$1.793	(\$0.002)
Oct-13	\$17.96	\$18.09	(\$0.13)	57.98¢	57.68¢	0.30¢	\$1.775	\$1.790	(\$0.015)
Nov-13	\$17.76	\$17.70	\$0.06	57.05¢	57.03¢	0.02¢	\$1.756	\$1.743	\$0.013
Dec-13	\$17.15	\$17.07	\$0.08	57.50¢	57.25¢	0.25¢	\$1.693	\$1.676	\$0.017
Jan-14	\$16.69	\$16.65	\$0.04	55.00¢	55.00¢	0.00¢	\$1.667	\$1.661	\$0.006
Feb-14	\$16.53	\$16.54	(\$0.01)	54.50¢	54.50¢	0.00¢	\$1.645	\$1.650	(\$0.005)
Mar-14	\$16.50	\$16.52	(\$0.02)	54.25¢	53.75¢	0.50¢	\$1.649	\$1.650	(\$0.001)
Apr-14	\$16.44	\$16.47	(\$0.03)	53.00¢	52.00¢	1.00¢	\$1.651	\$1.660	(\$0.009)
May-14	\$16.45	\$16.47	(\$0.02)	53.00¢	52.00¢	1.00¢	\$1.655	\$1.660	(\$0.005)
Jun-14	\$16.63	\$16.61	\$0.02	53.00¢	52.03¢	0.98¢	\$1.672	\$1.680	(\$0.008)
Jul-14	\$16.94	\$16.95	(\$0.01)	51.00¢	51.00¢	0.00¢	\$1.728	\$1.738	(\$0.010)
Aug-14	\$17.03	\$17.10	(\$0.07)	50.75¢	51.00¢	(0.25¢)	\$1.730	\$1.740	(\$0.010)
12 Mo Avg	\$17.02	\$17.03	(\$0.01)	54.61¢	54.24¢	0.37¢	\$1.701	\$1.703	(\$0.002)

- Fluid Milk East: Eastern manufacturing milk supplies continue to be tight; due to the combination of good Class I demand and seasonally lower milk production. A number of balancing plants have eliminated drying schedules. Forage supplies are becoming a concern in the Northeast region as the unusually wet summer has reduced hay harvest yields and quality. Milk production in Florida is at or near its seasonal low point. Producers are beginning to put more fresh cows online, but heavy rains over the past week have been detrimental to dairy production as many pastures are flooded. Class I demand remains very strong and prompted 216 spot loads to be imported this week. Import loads over the past few weeks have been their highest since 2006. Milk production in the Southeast region is about in balance with Class I demand needs, with manufacturing supplies near contract levels. Cream demand is active with good pulls coming from cream cheese, butter, ice cream and bottling manufacturers. The good cream demand has tightened available supplies and moved prices higher. Condensed skim milk supplies are very tight with most plants having adequate supplies to fill their fluid contracts, but little beyond that for spot sales or manufacturing.
- Fluid Milk Pacific Northwest: Milk production continues to decline seasonally. Milk production is short of processing capacity for the region and milk is being moved to most profitable locations.
- Butter: In the Northeast, butter production remains at reduced levels as good cream demand is pulling volumes away from churns. Some butter makers have good fall orders and would make more butter if cream volumes were readily available at lower prices. Export demand is also good with some plants focusing on 82% production. Higher international prices for butter continue to support the export market. In the Central region, cream spot loads for churning are still hard to find as milk production is recovering from the heat wave a few weeks back. In the West, butter demand is in full swing for the upcoming holidays. Butter churns are busy filling orders for print butter for retail and club stores. Tighter supplies of cream have manufacturers sending supplies to their most efficient plants. Western butter manufacturers are holding onto any cream supplies rather than selling to other cream users. Export demand is very good and plants are balancing domestic demand against good export orders. Bulk butter sales are steady and helping to clear excess inventory.
- NDM Central: Interest in NDM from resellers picked up with the talk of an upcoming NDM tender within the Americas. Current NDM production is well below plant capacity in the Central region. Nonfat dry milk inventories are variable.
- NDM West: The market tone has firmed following recent pricing increases and an overall perception of tight supplies. Demand from export buyers is driving much of the strength. U.S. manufacturers are busy filling export orders and are reducing domestic NDM production. Tight milk supplies are also restricting NDM production in the West with plants reporting reduced supplies for spot sales. High heat prices are higher with most plants reporting tight stocks. Increased seasonal demand from fall baking and blending mix users is noted.
- Cheese East: Milk supplies going to cheese plants remain tight, limiting cheese production. Most cheese makers would increase production, from their present levels, if they had more milk. Demand is good from both domestic and export buyers. Mozzarella sales have been especially strong. Cheese packaging facilities and warehouses are very active filling fall orders with inventories being worked lower. Cheese going into aging programs continues to be at a good pace.
- Cheese Midwest: Milk volumes going to cheese plants continue to decline, limiting cheese production at most plants. Export demand for cheese remains good. Domestic demand is mixed with strong orders for mozzarella, while process cheese orders are at typical seasonal levels. Some cheese makers have redirected some of their milk supply away from cheddar, to mozzarella production in order to meet demand. Contrary to the heavy supply image projected by the cold storage numbers, some cheese makers are being very cautious with their inventories, not wanting to over-sell for fear of not being able to fill future contract commitments.
- Cheese West: The market appears comfortable trading in this range with good sales and inventories moving to end users. Cheese production is down as milk supplies are at or near a seasonal low point. Plants are choosing to dedicate milk supplies to fill orders, but are finding it hard to increase production to build inventory. High prices for milk solids to fortify cheese vats are adding to the cheesemakers' dilemma. Export demand is good.
- Exports: CWT has accepted requests for export assistance to sell 4,041 million lbs of Cheddar, Gouda and Monterey Jack cheese and 992,080 lbs of butter to customers in Asia, Europe, the Middle East and North Africa. The product will be delivered this month through February 2014.
- International: In its latest dairy quarterly report, Rabobank says China is muscling out other buyers in its global hunt for dairy products as it attempts to fill holes caused by serious shortfalls in its domestic production. China, already the world's largest importer, swooped into the market for 27% more product in Q2 than in the 12 months prior. It is becoming increasingly apparent that China is facing a supply-side crisis,

with credible reports of a 6% contraction in milk production during the first half of 2013. With global exportable supply growth likely to lag, China still on the hunt for increased volumes, and accumulated demand from sidelined buyers, dairy prices may stay at high levels until Q2 2014.

- International: Oceania dairy product markets are seeing fair to good demand across product categories. There is good buying interest from China and other exporting partners. Trade sources report that Chinese demand is higher as they compensate for declines in fresh milk supplies, said to be around 5-6% lower than a year ago. Buyers are looking to replace the lack of production by importing more dairy products, especially whole milk powders. The impact is tightening up supplies in Oceania and keeping WMP pricing rather firm around the \$5,000 per MT mark. Butter price trends are higher, reflecting good demand. Traders/handlers are noting good demand from Russia.
- International: An article in Confectionary News this week reports manufacturers are worried about butter and milk powder shortages in the EU for the 2013/14 marketing year. Increased exports of dairy products and reduced milk production volumes have meant that EU butter production levels declined significantly in the first few months of 2013. This has meant that the EU domestic market supply of butter is now experiencing a severe shortage, leading to higher prices.

What's Bearish:

- Spot Market: Blocks finished the week down 4½¢ to settle at \$1.75/lb while barrels lost 4¼¢ to close at \$1.72/lb. Trading was on the lighter side with just 12 loads of blocks and 9 loads of barrels exchanging hands. Butter picked up a penny to settle at \$1.61/lb on heavy volume of 28 loads, while Grade A NDM was down 1½¢ to close at \$1.83/lb on just 2 trades.
- Ag Prices Report: While still low, the preliminary Sep milk-to-feed ration increased to 1.86 from 1.68 in Aug. This is the highest milk-feed ratio since July, 2011.
- Cold Storage Report: Butter stocks at the end of August were 34% higher than a year ago, but 9% lower than July. American cheese stocks were 3% higher than last year, while total cheese stocks registered a 5% gain.
- Cheese stocks in cold storage at USDA selected storage centers increased 1%, or 1.6 million lbs over the period 09/01 through 09/23.
- Fluid Milk Central: Farm milk production in the Central region regained some of the losses to high daytime temperatures that occurred in the last few weeks. Some processors note the increasing manufacturing milk volumes are having a possible effect on cheese production, and helping to make up for the draw from bottlers. Suppliers to the fluid industry indicate sales of milk loads into bottling are reaching equilibrium now as the school pipeline is considered satisfied, and retailers are continuing to run single product or bundled specials on bottled milk. Some ice cream manufacturers are not taking any more fluid milk as the seasonal ice cream demand is winding down. Many cheese plant operators are glad to have an uptick in farm milk intakes and few are interested selling loads of milk.
- Fluid Milk West: CA milk production is mostly steady with recent trends. Seasonally cooler weather patterns have reduced stress on dairy herds and that is positive to milk production. Class I needs have evened out with the pipeline for school milk well established. Milk processors are looking forward to increased production for October to better utilize plant efficiencies. August 2013 pool receipts of milk in CA totaled 3.27 billion pounds, 2.6% higher than last year, according to CDFA. AZ milk supplies are increasing slowly. This week saw temperatures dropping significantly if only for a short period of time. Manufacturers feel that the low point of the production season may have passed.
- Dry Whey Northeast: Production of dry whey has marginally decreased, due to seasonally lower milk volumes and components, but domestic demand continues to be flat. Export demand remains below manufacturers' expectations, which has prompted some price discounts as plant managers attempt to better manage their inventories.
- Dry Whey Central: Offers are being presented to end users from resellers and manufacturers at a slight discount due to extra volumes of dry whey on hand. Some end users indicated they have ample supplies and are not as active in seeking offers. Dry whey production has improved from the heat spell as lower temps and less humidity have improved dryer efficiencies.
- Dry Whey West: Increasing amounts of whey are beginning to be offered to the market and inventories are said to be building for some manufacturers. Buyer demand is good for immediate needs, but international buyers are looking for price breaks before committing to larger block purchases. Much of the Western whey is exported and there appears to be a weaker undertone to the export market.
- NDM East: Current price levels are meeting price resistance from prospective buyers. Despite very limited NDM production due to limited manufacturing milk supplies and a continuing drawdown of inventories, domestic demand has declined as numerous prospective buyers are looking to alternative lower priced products to fill their needs.
- International: Milk production is trending higher across many EU countries. For the EU-28 in July, milk was up 2.0% and indications are that August is up more than a year ago on a percentage basis. Some early August production figures versus a year ago show Germany at +3.5%, Netherlands +10.0%, and United Kingdom +5.0%. There are concerns about the higher production levels and what effects that will have on quota. There is some unsettledness to the market tone, especially into Q4.
- International: Australian milk production patterns are trending higher on a seasonal basis. Weather conditions are good. Water levels are in positive shape for the growing season for pastures and crops. Farm financials are beginning to be more favorable, following a year of transition. Processing plants are working well as milk intakes are building. New Zealand milk production is ramping higher. Conditions are favorable for the milking herds. Weather has been moderate with adequate to moderate rainfall. Pastures are seeing amazing growth in some regions. Milk output is forecast to be 6% higher with increased cow numbers and higher milk prices being major reasons. A new drying processing plant is operational and working well on the South Island.

Recommendation:

Despite fundamentals that suggest both milk and cheese are on the tighter side, spot cheese prices registered losses. However, Class III futures didn't crash, as is usually the case in a decline of that size. Why? Fundamentals are still bullish, the international market is strong and despite a bearish Cold Storage report, it's widely believed that commercial disappearance is very strong and inventories are now being drawn down quickly. We still feel like this market is coiling up and getting ready to make a move higher. Hedgers should stick with your sell orders: Oct upper \$18's, Nov upper \$17's to low \$18's, Dec mid \$17's. Hold off on 2014 for now as the demand from China (see above) could provide a lift.

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