

The KDM Dairy Report – October 25th, 2013

What's Bullish:

- Spot Market: Blocks gained 1¼¢ to settle at \$1.87½/lb while barrels jumped 5¼¢ to close at \$1.82/lb. Trading was on the lighter side with just 5 loads of blocks and 11 loads of barrels exchanging hands. Butter lost ¼¢ to settle at \$1.47½/lb on 5 trades, but Grade A nonfat dry milk picked up 4¢ to close at \$1.90/lb on just 1 trade.
- Fluid Milk East: Milk supplies remain tight in the Northeast due to the combination of seasonally lower milk production and strong Class I demand. Balancing plants are, for the most part, able to fill their fluid contracts, with minimal supplies remaining for manufacturing. Pasture conditions are

Futures Month	Class III 10/25	Class III 10/18	Change	Dry Whey 10/25	Dry Whey 10/18	Change	Cheese 10/25	Cheese 10/18	Change
Oct-13	\$18.25	\$18.25	\$0.00	57.75¢	58.25¢	(0.50¢)	\$1.803	\$1.803	\$0.000
Nov-13	\$18.73	\$18.32	\$0.41	58.00¢	58.75¢	(0.75¢)	\$1.858	\$1.810	\$0.048
Dec-13	\$17.94	\$17.72	\$0.22	58.75¢	59.50¢	(0.75¢)	\$1.777	\$1.747	\$0.030
Jan-14	\$17.09	\$17.07	\$0.02	57.83¢	58.00¢	(0.17¢)	\$1.692	\$1.690	\$0.002
Feb-14	\$16.80	\$16.77	\$0.03	57.35¢	57.00¢	0.35¢	\$1.662	\$1.659	\$0.003
Mar-14	\$16.70	\$16.65	\$0.05	56.85¢	56.25¢	0.60¢	\$1.655	\$1.655	\$0.000
Apr-14	\$16.68	\$16.57	\$0.11	55.83¢	55.50¢	0.33¢	\$1.655	\$1.655	\$0.000
May-14	\$16.62	\$16.65	(\$0.03)	54.55¢	54.25¢	0.30¢	\$1.660	\$1.660	\$0.000
Jun-14	\$16.88	\$16.92	(\$0.04)	54.03¢	53.25¢	0.77¢	\$1.680	\$1.687	(\$0.007)
Jul-14	\$17.06	\$17.12	(\$0.06)	53.00¢	52.00¢	1.00¢	\$1.723	\$1.722	\$0.001
Aug-14	\$17.10	\$17.13	(\$0.03)	52.50¢	51.00¢	1.50¢	\$1.726	\$1.725	\$0.001
Sep-14	\$17.17	\$17.12	\$0.05	50.00¢	49.00¢	1.00¢	\$1.740	\$1.740	\$0.000
12 Mo Avg	\$17.25	\$17.19	\$0.06	55.54¢	55.23¢	0.31¢	\$1.719	\$1.713	\$0.006

- beginning to decline in the Northeast and Mid-Atlantic regions, due to cooler temperatures and limited sunlight. Forage supplies for the upcoming winter remain a concern in the Northeast, especially in New England. Milk production in Florida is beginning to tick upward as more cows are freshening, but day time highs in the 90's are limiting those increases. Class I demand remains strong and prompted 178 loads to be imported this week, up from 117 a year ago. In the Southeast, milk supplies are nearly in balance with Class I demand. Manufacturing supplies are near minimum contract volumes. Cream demand is very strong with good pulls coming from cream cheese, sour cream, cream based dips and butter manufacturers. Spot cream sales are limited, due to the tight supply with some orders going unfulfilled. Condensed skim milk supplies are adequate to fill fluid contracts with limited supplies remaining for spot sales or manufacturing.
- Fluid Milk Central: Farm milk production in the Central region is holding steady to slightly increasing, but milk supplies are tight as premiums are being paid on spot loads at \$3.00 over Class. The tight milk supply has slowed some cheese manufacturers down. Some resellers indicated they were not able to supply all customer needs for milk supplies. Central cream supplies are tight due to churn operators keeping internal supplies. Soft serve demand has hung on longer than expected. Some processors are worried about the feed quality from this year's corn crop as its energy levels aren't as good as last year's crop.
- Fluid Milk Pacific Northwest: Milk production in the region is following typical seasonal declines. Class I demand is steady and handlers are moving manufacturing milk to plants with best efficiencies. Class II plants are gearing up production schedules for holiday needs. UT and ID milk supplies are steady to lower. Processors are handling the supply locally in most cases with capacity for any unexpected volumes.
- Butter Northeast: Production is very active as most plants are busy filling seasonally strong domestic print orders. Most plants are having to grind or microfix existing supplies to fill orders. Some plants continue to produce 82% butter to fill export orders. U.S. prices for butter remain below international levels, supporting export interest.
- Butter Central: Production has slowed as cream supplies are still tight due to seasonally tight milk supplies. Some manufacturers stated retailers are getting orders in slower than expected for the holidays, but export demand is strong as evident by the increased 82% production compared to 80%.
- Dry Whey Central: Prices are steady to trending higher. Offers are still being presented to end users from resellers and manufacturers with adequate supplies of dry whey, but sales have been active as some manufacturers are even reporting extra sales and steady shipment of product.
- NDM East: Prices for nonfat dry milk are firm. Nonfat dry milk production is limited in the East, due to the strong demand for milk and condensed skim from dairy product manufacturers. Good Class I demand, in combination with increased production of yogurt, cream cheese, cheese, is limiting condensed skim volumes going to NDM production. Demand for NDM is good and supplies are tight. Some buyers having trouble sourcing supplies in region and are attempting to source product outside the region with limited success at desired price levels.
- NDM Central: Prices are increasing on both the low/medium heat and high heat. Domestic interest has been relatively quiet, with most of the interest coming in the export markets. NDM production is reported to be growing but availability is still relatively tight.
- NDM West: Prices in the West are mostly higher and the market tone is steady to firm. Manufacturers indicate the September heat wave in California's Central Valley put some pressure on the seasonal rebound in milk production. Farm milk volumes reportedly plateaued over the last few weeks, but components are creeping higher. Demand from North American end users rose higher in recent weeks while demand from other parts of the world is steady. Several Western NDM manufacturers note inventories are tight, with current projections showing sold out positions throughout the balance of the year.
- Cheese East: Production is very active with most plants on 6 day production schedules. However, some cheese plants are reconstituting NDM supplies and purchasing cream to augment their reduced milk supplies. Sales and orders for mozzarella, Swiss, cheddar and aged cheeses are seasonally strong. Export sales continue to be active. Most cheese makers would increase production, from their present levels, if they had more milk. Cheese makers with aging programs are continuing to rebuild their supplies.
- Cheese Midwest: Buyers are searching for cheese. One manufacturer commented that "panic orders" are currently being received from buyers who let inventories decline during recent months, expecting to rebuild at lower "future" prices. Now the "future" is here and some retailers are below inventory levels they find comfortable. Last week's increase in block prices significantly contributed to the "panic orders" from grocers who needed to re-stock. As a result, a number of cheese manufacturers would "slightly" notch up cheese production if more milk were available, but extra spot milk is hard to find. Spot milk supplies are reported either "not available" at all in many parts of the region, or available

at prices so far outside the range of reasonable as to be considered "not available". Buyer interest is also playing out through cheese packagers, who some manufacturers believe are attempting to meet only more immediate buyer interest while maintaining some inventory for resulting anticipated continuing demand into the end of the year.

- Cheese West: Prices are mostly steady to firm. Strong domestic holiday buying interest continues as buyers look to secure inventories for the end of the year. Manufacturing schedules are steady to lower as available milk volumes are competing with Class IV demand. Export demand continues to move product into international channels often assisted by CWT programs. Current U.S. prices are competitive with world prices.
- CWT has accepted 11 requests for export assistance to sell 2.002 million lbs of Cheddar, Gouda and Monterey Jack cheese and 771,618 lbs of butter to customers in Asia, Central America, Europe, the Middle East and North Africa. The product will be delivered October 2013 through March 2014.
- The Foreign Ag Service reported that on a volume basis, exports of milk powder, cheese, butterfat, whey and lactose in August were 23% ahead of last year's pace. Ramped-up sales to China led the way, with powder exports up 170%. Cheese exports in August were up 40% from last year, with sales to Egypt nearly tripling. Butterfat exports were up a stunning 237% vs. a year ago and the most in five years. The U.S. exported 69% of its total NDM/SMP production and 6.7% of its cheese output.
- International: Australian milk production is at or near the seasonal peak but is trending 1-2% below last year. Tasmania has experienced cold, wet weather, causing decreased cow comfort levels and some marginal decreases in milk production. Victoria has also experienced wet weather conditions. Even with improved farmgate prices, numerous producers seem adverse to risk and hesitant to expand operations. Producers remain in a tight financial situation with tight margins. According to Dairy Australia, September milk production in Australia was 3.5% below September 2012.
- International: Oceania Cheddar production has seen some declines as milk volumes have been channeled to the more lucrative whole milk powder market. Supplies of cheddar are tightening and may forecast upward price movements in the short term for domestic buyers. Current Cheddar prices average \$2.00/lb for the week ended 10/25. Export demand is only fair at best as international customers continue to explore the U.S. market as a lower cost alternative.

What's Bearish:

- Dairy Products Report: Cheddar cheese output in August was up a strong 7.6% vs. a year ago and up 6% from July. Total cheese output increased 3.9% and 1.9% respectively. Butter production jumped 4.7% vs. Aug '13 and was 1.5% higher than the prior month.
- Most dairy products were lower in this week's Global Dairy Trade auction. The average price for all products declined 1.9% from the last auction two weeks ago. Butter Milk Powder and Butter were the largest decliners, falling 5.2% and 3.5% respectively. Skim milk powder inched 0.7% higher, but cheddar cheese fell 1.7% to a U.S. equivalent \$1.96/lb.
- Fluid Milk Southwest: Milk handlers in CA note the dairy herds are making a modest comeback on milk production volumes since the September heat wave. Component recovery is ahead of milk volumes, providing a small bump to butterfat and protein-based manufacturing. Milk handlers indicate dairy farmers in California continue to face some economic difficulties, but some dairy farmers are expanding their operations. Field work progress in NM benefitted from almost a full week of suitable weather. Depending on location, alfalfa growers are completing fifth, sixth, and seventh cuttings. Current weather is benefitting cow comfort and milk production is steady to seasonally higher.
- Butter West: Prices in the West are weaker following recent trends over the past two weeks. Churns are busy and butter supplies are ample as buyers are looking to purchase for the upcoming holidays. Export orders continue to move butter supplies offshore, though manufacturers are often able to use current stored inventories in addition to new production to fill orders.
- Dry Whey Northeast: Prices have weakened as some manufacturers have offered price discounts to multi-load purchases in an attempt to better manage their expanded supply. Dry whey production has increased as cheese manufacturers have expanded operations to 6-7 day production schedules in advance of the busy holiday season. Spot loads are readily available with spot market pricing is below index pricing. Demand is fair as dairy product manufacturing has increased. The increased production, atop the already adequate supplies, gives the dry whey market a weak undertone.
- Dry Whey West: Prices are mixed with an overall weaker undertone. Alternative whey protein products continue to compete for the whey stream supply from cheese manufacturers. Demand is mostly steady with spot buyers looking for price breaks. Some increased offerings are finding their way to the market. Export demand is good, yet buyers are looking for lower prices. Brokers and resellers are reporting lower price bids from international buyers.
- International: Milk production in most EU countries is higher than year ago levels, continuing the trend that started during the summer. The increases in milk production are being cautiously watched as concerns about exceeding quota levels are noted. Trade sources note that another factor is that higher milk volumes translate into more dairy products, which could pressure pricing. Farm milk production conditions remain good as milk prices are high, feed costs reasonable, and weather conditions have been favorable.
- International: New Zealand milk production in August was up 9.2% from August last year and 24.7% higher than two years ago. Current milk production is near the seasonal peak with estimates of a 4% increase over last year. Pastures are seen as in generally good condition. The new manufacturing plant in Darfield is operating at full capacity and assisting with the increased milk volumes.

Recommendation:

Weekly gov't reports are back, and in the short-term, reflect a tight market. Holiday cheese buyers, caught waiting for lower prices, are now uncomfortable with their lack of inventory and are being forced to pay up as they all try to secure product at the same time. Plants we talked to this week said they couldn't keep up with orders. We should see further strength in the front months next week assuming spot prices keep ticking higher. We really think this is short-term, however. Another 3-5 weeks of buying and they may be done for some time. The export story is amazing and should help support Q1 prices, but we believe a wall of milk is coming as producers increase cow numbers. Look to protect Q2-Q4. Consider the Apr-Dec 16.25 x 18.25 fence at an average cost of 10¢/month. With components and a positive PPD, it should provide a decent safety net.

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