

**The KDM Dairy Report – November 8<sup>th</sup>, 2013**

**What's Bullish:**

- Spot Market: Butter gained 2¼¢ on the week to settle at \$1.56/lb on 12 trades, while Grade A NDM was up 2¼¢ to \$1.93¼/lb on no trades.
- Dairy Products Report: Cheddar cheese output in September was 1.2% below year-ago levels, and down 10.8% from August. Butter output declined 1.9% and 1.6% respectively. Total cheese output was 2.3% higher than Sep '12, primarily from large increases in Hispanic and Italian varieties, but was down 4.7% from August.
- Fluid Milk Southeast: Class I demand has held steady in the Southeast region and is utilizing most available milk supplies. Manufacturing

Futures Month	Class III 11/08	Class III 11/01	Change	Dry Whey 11/08	Dry Whey 11/01	Change	Cheese 11/08	Cheese 11/01	Change
Nov-13	\$18.78	\$18.84	(\$0.06)	57.23¢	57.00¢	0.23¢	\$1.862	\$1.876	(\$0.014)
Dec-13	\$17.89	\$18.27	(\$0.38)	57.20¢	57.90¢	(0.70¢)	\$1.763	\$1.814	(\$0.051)
Jan-14	\$17.16	\$17.31	(\$0.15)	57.00¢	57.50¢	(0.50¢)	\$1.701	\$1.722	(\$0.021)
Feb-14	\$16.94	\$16.90	\$0.04	57.00¢	57.00¢	0.00¢	\$1.675	\$1.681	(\$0.006)
Mar-14	\$16.87	\$16.75	\$0.12	56.00¢	56.00¢	0.00¢	\$1.668	\$1.666	\$0.002
Apr-14	\$16.72	\$16.68	\$0.04	55.00¢	55.50¢	(0.50¢)	\$1.667	\$1.663	\$0.004
May-14	\$16.69	\$16.69	\$0.00	54.75¢	54.40¢	0.35¢	\$1.664	\$1.665	(\$0.001)
Jun-14	\$16.81	\$16.85	(\$0.04)	53.90¢	53.90¢	0.00¢	\$1.684	\$1.685	(\$0.001)
Jul-14	\$17.07	\$17.08	(\$0.01)	53.00¢	53.00¢	0.00¢	\$1.720	\$1.715	\$0.005
Aug-14	\$17.14	\$17.08	\$0.06	53.00¢	52.50¢	0.50¢	\$1.726	\$1.726	\$0.000
Sep-14	\$17.16	\$17.14	\$0.02	51.00¢	51.00¢	0.00¢	\$1.735	\$1.735	\$0.000
Oct-14	\$17.15	\$17.08	\$0.07	51.00¢	51.50¢	(0.50¢)	\$1.730	\$1.730	\$0.000
<b>12 Mo Avg</b>	<b>\$17.20</b>	<b>\$17.22</b>	<b>(\$0.02)</b>	<b>54.67¢</b>	<b>54.77¢</b>	<b>(0.09¢)</b>	<b>\$1.716</b>	<b>\$1.723</b>	<b>(\$0.007)</b>

- milk volumes are tight with some contracts being shorted to in order to meet bottling demand. Demand for cream remains strong with good pulls coming from nearly all cream based dairy product manufacturers. Eggnog production is especially active. Supplies of cream are tight within the region with some manufacturers having to source product from outside the region. Spot cream sales are light, due to the tight supplies.
- Fluid Milk Central: Milk supplies are tight in the region. Milk sellers are still receiving premiums for spot loads, ranging from \$2.00 to \$3.00 per cwt above class. Milk production is increasing slightly and components are improved, but some processors are only able to fulfill current contract commitments. Some cheese manufacturers are not running at full capacity due to difficulty in finding milk. Class II demand has increased for dairy products such as sour cream, half and half, and whipping cream. Cream demand is steady to strong and supplies are tight.
- Fluid Milk Southwest: Dairy farmers in the Southwest continue to face economic challenges in planning for the upcoming year. Covering feed input costs remains a concern. Competing uses for corn have reduced corn use in rations for some operators. Recent decreases in corn prices are welcome, but still require finding a way to make its inclusion at higher rates pencil out. Cottonseed is reportedly priced out of the market at this time. CA milk production is about steady, while butter/powder production is on the rise as print orders remain active, though bottled milk use in NM is declining somewhat, sending more milk volumes into cheese production.
- Fluid Milk Pacific Northwest: Milk supplies are steady to slightly lower in the region, while cheese plants are seeing some reduced volumes as powder plants run heavier schedules. ID milk supplies are down from year ago levels due to lower cow numbers and steady production numbers per cow. Demand for milk currently surpasses supply in some cases.
- Butter: Good to strong seasonal demand combined with tight cream supplies have butter prices firm to higher in the Northeast and Western regions, while mixed in the Central region. Butter manufacturers are busy fulfilling retail orders for domestic holiday demand across the country. Churning is at or near full capacity across the regions. Some butter makers in the Central are turning away orders due to reduced cream supply. International interest in 82% is active in the Northeast and West regions. Butter inventories are decreasing across the nation but are at comfortable levels for current needs. In the Northeast, some plants are continuing to microfix stored butter to keep up with demand.
- Dry Whey: Dry whey inventories in the Northeast have been reduced in recent weeks via discounted sales. Production has declined in the region as a cheese plant has shut down for a number of days, due to planned maintenance projects. Demand is lackluster, but the reductions in supplies and production have given the market a steady to firm undertone. In the Central region, production is mixed with some manufacturers seeing a reduction in production due to tight milk supplies. Demand for dry whey ranges from good to steady, reflecting increased sales for some manufacturers. Western whey production is lower as cheese manufacturing is down due to tight milk supplies. Some additional downtime for unscheduled maintenance also reduced some production totals in the region. Export demand is steady, but export sales are under pressure from European Union dry whey offerings at lower prices.
- NDM East: Prices moved higher this week as steady demand combined with tight supplies continue to give the market a firm undertone. Production increased marginally as milk volumes expanded as some Class III manufacturing plants reduced production. Inventories remain tight in the region with some buyers seeking to purchase additional loads having to look outside the region to source product.
- NDM Central: Prices increased this week as the market tone is firm due to lack of available supplies and steady to strong demand. Nonfat dry milk is seeing steady international interest, especially into Mexico. Many manufacturers are stating they are in a sold-out position and moving product readily only when available.
- NDM West: Prices are higher on a firm market. Various manufacturers indicate stocks on hand are light for serving domestic spot market interest. Sales into the international market continue actively as the U.S. remains a first tier supplier into many international end users. Many buyers expected a weakening nonfat dry milk price trend in Q4, and some international buyers delayed late Q3 purchasing. With no price weakness in the near term forecast, though, some of those end users are making up for lost time on their NDM purchases.
- Cheese East: Seasonally strong cheese sales are maintaining 6-7 day production schedules at most cheese plants. Regional cheese production has declined as a plant will be shut down for an extended period for planned maintenance. Inventories are being worked lower as orders are being filled. Rising component levels are continuing to improve cheese yields. Export activity has declined due to manufacturers needing to focus on covering seasonally strong domestic demand.
- Cheese Midwest: Milk supplies into Midwest cheese plants are reported to be mostly steady, but block manufacturers would prefer to see some additional supplies. Competition from butter/powder plants for spot milk is adding to the price. Block demand remains good with moderate

barrel demand. Retail demand for upcoming holidays is driving much of the block market. Cut and wrap operations are busy filling orders and are looking to increase inventories. Block supplies are tight with some excess barrel inventories.

- Cheese West: Good seasonal sales into retail accounts and brokers are helping to firm block cheese sales, while higher prices have slowed some spot activity in the barrel market. Swiss cheese prices also firmed as Class III price adjustments were released. Tight milk supplies and competition from Class II and IV manufacturers are limiting cheese production. At current production levels, some manufacturers report tight inventories available for additional spot sales.
- CWT has accepted 32 requests for export assistance from Bongards Creameries, Dairy Farmers of America, Foremost Farms USA, Land O'Lakes, Northwest Dairy Association (Darigold) and Tillamook County Creamery Association to sell 3.344 million pounds of Cheddar and Monterey Jack cheese and 3.463 million pounds of butter to customers in Asia, Central America, Europe, the Middle East and North Africa. The product will be delivered in November 2013 through April 2014.
- Grains: Today's Crop Production Report was expected to confirm the large size of the corn and bean crops. Corn ending stocks came in below most analysts' expectations, while usage for beans was increased 103 million bu from the last update, which caused a short-covering rally. Beans finished the day up nearly 30¢/bu in most contracts, while meal prices saw gains of \$16-18/ton through Mar.
- International: While this week's Global Dairy Trade auction saw an overall 1.8% decrease in their GDT Price Index, Cheddar cheese prices actually increased 1.2% to a U.S. equivalent \$1.99/lb. Whole Milk Powder declined 3.7% and butter fell 7%, but Anhydrous Milk Fat increased 6.9% and Skim Milk Powder was up 0.5%.
- International: Milk production in Western Europe is moving downwards towards the seasonal low point, though output is ahead of last year. Offerings of finished dairy products are lower with many trading books closed for the rest of the calendar year. Eastern European milk production is holding mostly along recent patterns, though dairy product production is trending lower and reflects the seasonal drop in milk output. Products are available on a limited basis.
- International: Demand for SMP in Oceania remains strong, with a majority of the stocks committed. The strong demand, tight stocks situation is moving prices higher. Cheddar production continues to decline as milk volumes are being diverted to whole milk powder production, due to the greater returns. Most cheese manufacturers are gearing production to fill only contract orders. In some cases, product is not available in sufficient supplies for export. The tight supply has moved prices higher, to a U.S. equivalent \$2.06/lb this week.

#### What's Bearish:

- Spot Market: Blocks fell 8¢ for the week to settle at \$1.82¼/lb while barrels gave up 9¼¢ to close at \$1.78¼/lb. There were just 3 block trades all week, with no barrel trades.
- World Ag Supply & Demand Report: USDA increased their 2014 milk production forecast on the expectation that producers will respond to lower feed prices and increase the size of the herd. As a result, they lowered their cheese and whey price forecasts, which in turn caused their Class III forecast to fall by 25¢/cwt from their last estimate, to an avg \$17.30.
- Fluid Milk East: Manufacturing milk supplies have increased in the Mid-Atlantic and Northeast regions, primarily due to some plants shutting down or limiting production schedules to perform planned maintenance for a day or more. Milk volumes are adequate to cover fluid contracts. Class I demand is steady. Milk production is increasing along the seasonal trend. Class I demand declined marginally in Florida this week, but is expected to bounce back as the Thanksgiving Day holiday nears. Weather conditions have been good for milk production. Daily rains over the past week have relieved dry conditions in various areas of the state. The decrease in Class I demand lowered import spot loads to 88 this week, from 120 last week.
- Europe's central bank unexpectedly cut their interest rate by 25 basis points, sending the Euro sharply lower versus the USD, while stronger than expected economic/jobs numbers further strengthened the dollar. The rising value of the USD vs. both European and Oceania currencies will make our exports more expensive on the world market, and is generally seen as bearish to commodities.
- International: The peak in Australian milk production was below year ago levels, but the outlook is good for the second half of the production season to extend beyond last year. Milk producers have the means to extend the season as long as weather allows, having milk prices above year ago levels with reasonable feed supplies and prices. New Zealand milk production is beyond the peak, but continues to show production gains of 4-5% over last year. Some of the production increases can be attributed to an increase in the number of farms in the Canterbury and Southland regions.

#### Recommendation:

Block cheese remains tight around the country, but that's not the case for barrels. Prices were steady until Wednesday, when barrels fell 7¼¢. With the block/barrel spread getting as wide as 10¼¢ on Thursday, blocks gave up their entire weekly loss of 8¢ during Friday's spot session. There is a lot of guessing now as far as where we go next week. Remember how bullish everything looked last week? Indeed, upon the open of the Sunday evening session, Class III prices were sharply higher. But I think we rightly pointed out last week that \$1.90+ cheese is getting up there, it's just that we didn't think it would correct so quickly. On the other hand, blocks are tight and milk is still tight. Cheese plants are looking for milk and can't find it, and we even heard reports of empty milk silos and lower cheese output. NDM demand is still strong, pushing Class IV to about \$21.30/cwt. Even with this week's losses in the spot market, Class III works out to about \$18.30/cwt. Assuming prices don't fall much more next week, Dec Class III could jump back up over \$18 again. Q1 hit a high of \$17.16 avg. We would target to sell 20-25% of your milk there, and another 20-25% at \$17.50 avg. Q2-Q4 we still like the 16.25 x 18.25 fence at an average cost of 10¢/month. Maybe bump your bid up to 15¢/mo on 25% of your production to get something done there. Longer term, we are still mostly bearish as we believe producers will continue to add cows at these profit margins.

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