

The KDM Dairy Report – November 22nd, 2013

What's Bullish:

- Spot Market: Blocks picked up 1½¢ on just 2 trades to finish the week at \$1.83½/lb. Barrels lost just ¼¢ on 2 trades to settle at \$1.75½/lb. Butter jumped 3¢ on 7 trades to close at \$1.68/lb, while Grade A NDM gained 1¢ on 3 trades to \$1.98½/lb.
- USDA's weekly cold storage report is showing a strong seasonal drawdown of both butter and cheese holdings. For the period 11/01 through 11/18, butter stocks at selected storage centers fell 25%, or 3 million lbs, while cheese stocks declined 3%, or 3.5 million lbs.
- Fluid Milk East: The week prior to Thanksgiving is typically the busiest week of the year for bottling plants in the Northeast and Mid-Atlantic regions and this year is no exception. Class I demand is very strong. Balancing plants' milk supplies are at reduced volumes with some plant managers electing to move all of their milk supplies through fluid contracts. Seasonal residents are returning to Florida and with the influx, Class I demand is increasing. Import spot loads totaled 70 this week, up from 35 last week. Class I demand is very strong in the Southeast region with multiple loads being added on by bottling plants as they prepare for the upcoming holiday week. Milk supplies are adequate to meet current demand needs with manufacturing plant supplies being kept at their contract minimums. Cream demand is very strong with strong pulls coming from cream cheese, cream based dip, and eggnog manufacturers. One broker stated he's not expecting cream multiples to drop off significantly over the Thanksgiving holiday, believing there's an inadequate cream supply to meet the demand needs from Thanksgiving to the Super Bowl.
- Fluid Milk Central: Milk supplies are tight due to holiday demand, with some spot loads still priced as high as \$3 over class. Class I demand is strong as many milk processors are filling contract obligations and seeing new buyers. Retail stores are running milk gallon promotions and selling eggnog. Class II demand continues to remain strong as manufacturers are paying premiums on condensed skim. Butter churners continue to pay higher prices for cream to meet fourth quarter demand. Cheese makers are paying premiums for milk as well.
- Fluid Milk Southwest: Despite milk production in CA increasing slowly, most processors are running well below capacity. NM milk supplies are flat this week compared to last week and cheese production is off some this week due to maintenance projects. Cream availability is tight for current demand. Butter manufacturers are pulling heavily to fill holiday orders. Demand from Class II for production of holiday products such as eggnog and other cream based products is also adding to the tight supply situation.
- Fluid Milk Pacific Northwest: Milk production is still declining slowly along expected seasonal lines. Increases in cow numbers have helped to keep milk supplies above year ago levels, but processors in the region are short of desired milk volumes for manufacturing. Class I demand is good this week. UT and ID milk production is steady, but lower cow numbers in the region have reduced milk production below year ago levels. Demand from processors is often above current milk supplies.
- Butter East: Butter production has declined significantly from last week as demand for cream is very strong and pulling volumes away from churns. Some butter makers are resigned to selling cream at higher multiples with an eye on increasing production over the holiday period when supplies are more readily available. Butter inventories are being worked lower as microfixing and grinding are needed to fill current orders. Export demand is active with a majority of orders scheduled for shipment in the first and/or second quarter of 2014.
- Butter Central: Prices are steady to strengthening from strong domestic demand and good international interest. Butter makers are busy churning and microfixing to fill domestic retail orders. Some butter manufacturers are finding it hard to keep up with domestic demand due to tight and pricey cream supplies. Inventories for most butter plants are reducing as retail takes product while others have adequate stocks.
- Butter West: Prices are stronger this week with retail demand continuing to be very good. Butter producers are busy filling holiday demand for print butter. Cream supplies are tight and some manufacturers are trying to find additional cream for export butter orders. Stocks of butter are often tightening at a faster than expected pace.
- Dry Whey Northeast: Production of dry whey decreased in the region as a couple of cheese manufacturing plants carried out maintenance projects. Domestic demand is flat but export activity has increased with multiple load sales. Northeast dry whey stocks are tightening due to the increase of export sales. Some manufacturers' stocks are committed through 2013. The market undertone is firm.
- Dry Whey West: Production of whey is limited by lower cheese production and competition from other whey stream products. Demand is described as good with supplies in balance with current needs.
- NDM East: Prices increased this week as both spot sale and index prices moved higher. Production in the East is mixed with some increases in New England, but the rest of the region is showing reduced production schedules. Those manufacturers with reduced milk intakes are focusing on high heat NDM production. Supplies are fairly tight with some buyers having difficulty sourcing product. Export demand is good, but domestic demand is flat. The market has a firm undertone.
- NDM Central: Prices moved higher this week. The market tone is firm with many manufacturers in sold-out positions. Some resellers are beginning to receive offers. Domestic demand is catching up to the strong interest from international countries.
- NDM West: Tight supplies combined with higher than expected prices continue to keep some end users scrambling to secure inventories. The market tone is firm as few buyers are in a position of strength when looking to secure additional supplies. Production of NDM is limited by competition to make skim milk powder for the international market. There is a price advantage in manufacturing SMP versus NDM at current world prices. High heat NDM production is also limited with most manufacturers running product to fill contract demand and having little surplus to offer to the market.
- Cheese Northeast: Cheese production in the region is mixed. Some cheese makers are limiting production due to maintenance projects, while others are pushing 7 day production schedules. Demand for cheese is very strong with warehouse managers busy filling holiday orders. Export demand remains active as European cheese supplies remain tight and priced above U.S. levels.

Futures Month	Class III 11/22	Class III 11/15	Change
Nov-13	\$18.79	\$18.82	(\$0.03)
Dec-13	\$18.08	\$17.98	\$0.10
Jan-14	\$17.32	\$17.36	(\$0.04)
Feb-14	\$16.95	\$16.95	\$0.00
Mar-14	\$16.77	\$16.78	(\$0.01)
Apr-14	\$16.73	\$16.73	\$0.00
May-14	\$16.70	\$16.72	(\$0.02)
Jun-14	\$16.85	\$16.80	\$0.05
Jul-14	\$17.09	\$17.05	\$0.04
Aug-14	\$17.15	\$17.08	\$0.07
Sep-14	\$17.18	\$17.16	\$0.02
Oct-14	\$17.20	\$17.18	\$0.02
12 Mo Avg	\$17.23	\$17.22	\$0.02

- Cheese West: Cheese production is limited by tight milk supplies. Retail demand is good with block cheese clearing quickly. Barrel cheese demand is lighter as processors look for lower pricing, but cheese stocks are in balance for most needs.
- Exports: September year over year exports were up by 40% for cheese, 36% for nonfat dry milk, 41% for dry whey and 720% for butter. Exports were equivalent to 17.5% of September milk production, and for the January through September period, 15.5% of milk production compared to 13.5% last year. 2013 is likely to finish with exports at a new record high.
- International: Milk production in Western Europe is trending higher and early November estimates have milk intakes above year ago levels. However, current cheese supplies are insufficient to meet demand. Demand for dairy powders is good across the board, especially skim and whole milk powder. Most dry product supplies, except sweet whey powder, are committed through the end of 2013. Cream supplies are very tight with volumes being channeled away from bulk butter production to products with greater returns. In Eastern Europe, milk production is at or near the seasonal low point with overall production lagging behind year ago levels. Some butter is being exported out of Poland and into Russia. Milk prices paid to producers have increased in recent months, but have not kept pace with prices paid in Western Europe. Lower milk production levels have reduced dairy product production and tightened supplies available for export.\
- International: Australian milk production is steady but trailing a year ago by 3-4%. Forecasts for the season are being reduced with the expectation of milk volumes being at year ago levels. The implications of the milk supplies are steady to firm product prices. There is good demand from both domestic and export accounts. New Zealand milk output is running about 4-5% higher, June through October. Despite the increase in production, the whole milk powder market remains well balanced from a demand and price position. Even at seasonally high output, WMP pricing is being maintained. Good export demand in the world market, especially from China, is helping to clear offerings. Cheddar cheese production in Oceania is often lower as returns favor making WMP. Demand is fair to good, and the lower supplies are creating additional concerns about nearby coverage. Some traders/handlers are moving prices higher, with the average this week reaching a U.S. equivalent \$2.14/lb. Cheese holdings are light to moderate for servicing export accounts. According to Dairy Australia, cheddar cheese production in Australia from July-September was 12.9% lower than a year earlier.
- International: A relaxation of China's one-child policy may lead to stronger dairy demand, according to an Australian news report. The baby food market in China is already one of the fastest growing products in that market, but it's mainly due to more consumer spending and the growing middle class. It's thought any increase in births will feed in to that, but may not really change the dynamics dramatically.

What's Bearish:

- Milk Production Report: October milk output was up 1% vs. a year ago, though cow numbers declined slightly from the prior month. Overall, the dairy herd was 13,000 head higher than a year ago, and a 15 lbs/cow gain helped push production higher.
- Cold Storage Report: Butter stocks at the end of October were up 20% vs. a year ago, while both American and Total cheese stocks were 3% higher than last Oct.
- Livestock Slaughter Report: 276,800 dairy cows were removed from the milking herd in October, down 3% from a year ago, when 285,400 head were culled. Dairies are hanging on to cows.
- Dairy cow slaughter for the week ended 11/09 totaled 61,100 head, down 5% from a year ago, and the sixth straight week of below year-ago levels.
- Fluid Milk Central: Farm milk production is slightly above seasonal averages and dairy producers say they expect to keep producing at higher levels with relatively nothing holding them back. Milk supplies are tight due to holiday demand but are becoming more and more available. As 2013 corn silage continues to improve, cheese manufacturers have been seeing components rise in milk supplies. Many different dairy product plants are looking into increasing capacity levels through expansion.
- Fluid Milk Southwest: Milk production in CA is increasing slowly. Favorable weather conditions for milk production have helped to increase milk supplies. Various processors report milk supplies creeping higher. Dairies are beginning to take advantage of lower feed costs and looking at possible expansion plans. Recent changes to base pricing formulas at some co-ops are also encouraging some dairies to look at building herd numbers. Milk production in AZ is increasing with more cows in the herd and good weather conditions for dairies. Component levels are increasing and helping processors to achieve better yields.
- Dry Whey Central: Demand is moderate to good, but some buyers are waiting to see what the market does. Production for dry whey is slightly increasing as cheese manufacturers are increasing vat numbers per week. Users of dry whey are able to find product. Manufacturers have balanced to slightly increased dry whey stocks.
- Cheese Midwest: Prices for cheese in the Midwest region are reported from steady to weakening. Sales for cheese manufacturers have been mixed. Some cheese makers are seeing a lull in demand while others have not been able to keep up with sale orders due to tight milk supplies or capacity constraints.

Recommendation:

It was generally a quiet week in the spot market as trade volume was low, but blocks managed to inch higher while butter and NDM saw decent gains. Milk production is generally increasing across the U.S., but manufacturing milk is still tight. While the Cold Storage Report showed both butter and cheese inventories above year ago levels, demand for both was strong during the month as butter stocks declined a massive 25% from Sep and American cheese stocks fell 5%. Maybe even more significant is international demand. Year over year growth in September exports was amazing, Europe is tight butter, cheese and powder, while China is buying all the powder Oceania can produce. Cheese stocks are getting tighter in Australia. This is pulling more U.S. milk into dryers to satisfy export demand, limiting domestic cheese output, and this is firming up the dry whey market. If exports continue to be very strong beyond the holidays, we may see a pop in 2014 prices. We're still wary of how much new milk will be coming online in the U.S. however, as producers are definitely working on expansions. Which side will tip the scales? If we had to make a guess, we are feeling more optimistic about 2014 prices than we were even a few weeks ago. We're raising our Q1 sell target to 17.35 avg. We still like the Apr-Dec 16.25 x 18.25 fence at an average cost of 10-15¢/month.

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