

**The KDM Dairy Report – November 27<sup>th</sup>, 2013**

**What's Bullish:**

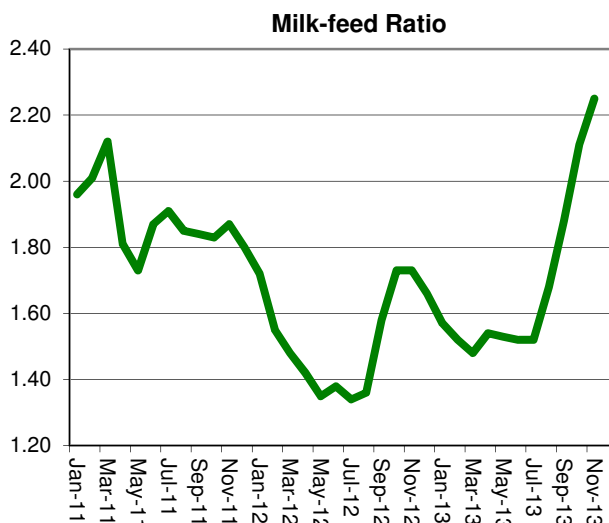
Futures Month	Class III 11/27	Class III 11/22	Change	Dry Whey 11/27	Dry Whey 11/22	Change	Cheese 11/27	Cheese 11/22	Change
Nov-13	\$18.80	\$18.79	\$0.01	57.35c	57.35c	0.00c	\$1.860	\$1.860	\$0.000
Dec-13	\$18.47	\$18.08	\$0.39	58.68c	58.25c	0.42c	\$1.814	\$1.780	\$0.034
Jan-14	\$17.72	\$17.32	\$0.40	57.75c	56.50c	1.25c	\$1.750	\$1.717	\$0.033
Feb-14	\$17.28	\$16.95	\$0.33	57.50c	56.75c	0.75c	\$1.702	\$1.680	\$0.022
Mar-14	\$17.00	\$16.77	\$0.23	56.75c	56.00c	0.75c	\$1.681	\$1.663	\$0.018
Apr-14	\$16.91	\$16.73	\$0.18	55.78c	55.13c	0.65c	\$1.675	\$1.667	\$0.008
May-14	\$16.84	\$16.70	\$0.14	55.25c	55.25c	0.00c	\$1.672	\$1.660	\$0.012
Jun-14	\$16.92	\$16.85	\$0.07	54.53c	54.03c	0.50c	\$1.689	\$1.681	\$0.008
Jul-14	\$17.17	\$17.09	\$0.08	54.00c	53.25c	0.75c	\$1.712	\$1.710	\$0.002
Aug-14	\$17.20	\$17.15	\$0.05	53.28c	53.25c	0.02c	\$1.720	\$1.715	\$0.005
Sep-14	\$17.22	\$17.18	\$0.04	53.00c	51.75c	1.25c	\$1.732	\$1.735	(\$0.003)
Oct-14	\$17.24	\$17.20	\$0.04	52.00c	51.00c	1.00c	\$1.734	\$1.731	\$0.003
12 Mo Avg	\$17.40	\$17.23	\$0.16	55.49c	54.88c	0.61c	\$1.728	\$1.717	\$0.012

- Spot Market: In a holiday-shortened week, blocks gained a solid 4¼¢ to settle at \$1.88/lb on 6 trades, while barrels gained 2¼¢ to \$1.77¼/lb on 8 trades. Butter lost 3¢ to close at \$1.65/lb on 5 trades, but Grade A NDM hit \$2.00/lb, up 1¢, on 2 trades.
- Cold storage numbers continue to show a strong seasonal drawdown in both cheese and butter stocks. For the period 11/01 through 11/25, cheese stocks at USDA selected warehouses fell 5%, or 5.768 million lbs, while butter stocks over the same period plummeted 35%, or 4.201 million lbs.
- Fluid Milk Southeast: A cold November in the North has caused an early influx of tourists and seasonal residents to Florida and, as a result, Class I demand is very strong. Because of increased consumer demand, retail dairy cases need to be restocked more frequently this holiday. Milk production in the state is on the rise, but not increasing at the rate anticipated. Cream demand held fairly strong in the early portion of the week, but declined as the week progressed. Demand is expected to snap back quickly after the holiday as numerous manufacturers resume full production schedules, preparing for the yearend holidays.
- Fluid Milk Central: Milk production is flat to slightly increasing in the region, with levels coming back from seasonal lows slower than expected. Some milk handlers haven't been able to pinpoint a specific reason why, considering recent reduction in culling and improving feed qualities. Bottling demand is slowing down as Thanksgiving demand is being met, but Class I interest is expected to pick back up early next week. Class II demand is good to strong, following seasonal trends. Some cream and dip manufacturers still need more supplies to meet holiday orders. Cheese manufacturers are looking for more milk so they can keep up with increased holiday cheese orders.
- Fluid Milk Southwest: CA milk production is slowly trending higher, but YTD through October 2013 milk receipts are 2.7% lower than a year ago. NM milk production is mostly steady this week, but farm milk transportation was slower as tanker drivers dealt with a storm system that began as rain and progressed to freezing rain and snow as temperatures fell. Processors in AZ noted slight decreases in milk intakes at the beginning of the week. Recent storms delivered over 2 inches of rain to some areas of Arizona over the weekend, making some dairy lots muddy and uncomfortable for the cows.
- Fluid Milk Pacific Northwest: Milk production in the region is nearing seasonal lows. Good manufacturing demand from various plants has other factories working at below desired volumes. Dairies are being encouraged to increase production, but financing for expansion can be a challenge to obtain.
- Butter Central: The market tone for butter in the region remains firm as manufacturers scramble to fill domestic holiday orders. Some butter plants are microfixing butter stocks to meet print orders. Butter buyers are having some difficulty locating bulk butter. Stocks of butter are tracking seasonal lows.
- Butter Northeast: Demand for butter continues to be good this holiday season. Export demand remains fairly active with some plants scheduling 82% production runs to fill existing orders. Most butter makers are comfortable with their current inventories.
- Dry Whey Northeast: Prices increased marginally this week. Though production of dry whey is increasing, export demand continues to be active with domestic interest picking up just prior to the holiday. Most manufacturers are comfortable with their current inventories with some having most of their current inventories committed through the end of the year. The market undertone is firm.
- Dry Whey Central: Prices in the region strengthened this week. Domestic demand for dry whey is steady to good, with international interest picking up.
- Dry Whey West: Prices are fractionally higher on strength at the upper end of the market. The market tone is firm to mostly steady.
- NDM East: Production is increasing this week as various dairy manufacturers scale down production for the holiday period, increasing condensed skim milk volumes going to dryers, but current inventories are fairly tight. Prospective buyers are looking outside the region or into resale opportunities in order to secure product. Some end users who have purchased hand to mouth, in hopes of lower prices, are now faced with needing product for end of year production schedules.
- NDM Central: The market is firm but is said to be loosening up some compared to prior weeks. Buyers are still finding it difficult to locate product and reported to only be buying what they need. Many NDM manufacturers are fulfilling current contract obligations and have little to sell in the spot market.
- NDM West: Prices stepped higher this week and buyer interest is steady for spot loads. Manufacturers are sending a limited number of loads to the spot market as internal supplies are light. Sales of nonfat dry milk loads into the Central and East regions continue on both F.O.B. and contract bases to fill supply gaps in those regions.
- Cheese East: Cheese production declined in the region this week as a major cheese maker shut down operations for the holiday period. Demand and orders for cheese remain good with supplies clearing out of warehouses at an active pace.
- Cheese Midwest: A number of larger cheese manufacturers are keeping inventories tight by design, in some cases, the tightest of the year over the next week or so. There is cheese to fill orders, but less of a cushion than during recent months. Manufacturers are okay with filling orders by reducing inventory. As a general rule, there is little if any surplus producer milk available at prices that can be accommodated profitability. Some cheese plants have reduced the number of days a week that cheese is being made.
- CWT has accepted 36 requests for export assistance to sell 9.760 million lbs of Cheddar, Gouda and Monterey Jack cheese and 3.003 million lbs of butter to customers in Asia, Central America, Europe, the Middle East and North Africa. The product will be delivered in November 2013 through May 2014.

- Feed/protein: In five trading days, Dec meal went from a low of \$404.60/ton to a high of \$457.90/ton, settling near the highs at \$445.90/ton, a 10%+ increase!
- International: A new strain of parasite which makes cattle anemic has invaded over 300 farms in New Zealand, many of them lucrative dairy farms, and about 20 new herds are being infected each week. The parasite, called ilaria ikeda, kills about 1% of the cattle it infects and makes a third or the rest ill.
- International: Dairy analysts Rabobank have reported that traditionally low-cost pasture-based dairying regions, such as New Zealand, have lost their cost advantage as input prices have risen. They now compete on the global market with a similar cost of production to producers with more intensive farming systems like the U.S., according to their recently-released industry update.
- International: The number of milk cows in China has decreased by 20%-25% (2 million head) this year from last year's 8-9 million, leading to a decline in milk production of 15%-20%, according to an expert in the dairy industry. The insufficient milk supply will continue to push up the price of raw milk, which has jumped from \$690 per ton to \$855 within a month. The current milk supply was estimated at 35 million tons, but the market demand is closer to 40 million tons.

#### What's Bearish:

- Ag Prices Report: The milk-to-feed ratio increased to 2.25 in November, up from 2.11 in October and the highest ratio since September 2010.
- Fluid Milk Northeast: Manufacturing milk supplies are building as the week progresses as various dairy product manufacturers decrease production schedules leading up to the holiday. Most balancing plants will receive expanded milk volumes over the holiday weekend.
- Butter West: The butter markets in the West are unsettled. Manufacturers are still churning print butter for last minute orders, but are expecting some relief soon. Increased cream availability is expected over the holiday and bulk butter production is anticipated to increase. Butter stocks are sufficient for immediate needs for both domestic and export orders.
- Cheese West: Good retail demand for blocks is helping to move prices higher, while barrel demand is lackluster at current prices. Some manufacturers have commented that holiday cheese orders this year do not seem as strong as recent years.



#### Recommendation:

A lot of international news out this week that is supportive of the dairy market. From a big drop in the dairy herd in China to a parasite in New Zealand, the 2014 export picture is looking brighter every day. And this wall of domestic milk we've been talking about has been slow to develop. Manufacturing milk is still tight over much of the country, while seasonal production increases have been less than expected. Credit is tight in some areas, limiting expansion plans. On the bearish side, barrel demand is weak and our sources tell us there is cheese out there to be sold. Within a couple weeks, orders should fall as well, due to insufficient lead times before year-end holidays. Our target to sell Q1 at \$17.35 avg came within a penny today. With positive momentum and Jan milk futures breaking through prior resistance going back to June, we would raise that target again to \$17.49 avg. We still like the Apr-Dec 16.25 x 18.25 fence at an average cost of 10-15¢/month, but would limit that to no more than 20-25% of your production. There are still too many unknowns and we continue to grow more friendly toward 2014 prices than we were just a few weeks ago. Class III finished the short week well in the green, with Dec-Feb the biggest gainers. Dry whey, after being stuck in the mid-50s since April, looks like it could make a run to 60¢. At \$18.47, Dec futures are still trading a slight discount to cash, which works out to about \$18.70. Should spot cheese hold or go higher next week, Dec-Feb will likely move higher as well. And with Grade A NDM hitting \$2.00/lb this week, Class IV works out to a lofty \$22.25/cwt, a \$3.50+ premium to Class III. Until world demand for powder is satisfied, this spread is likely to continue. The demand for powder does support Class III however, in that drying operations will continue to attract milk for its better return, leaving less available for the vat. We would not be surprised to see a spike higher in Class III at some point in the near future; open interest among non-commercials as of 11/19 shows there are 1,000+ more short the market than long, leading to a possible short-covering rally. But this could be followed by a substantial correction as holiday orders dry up. Be ready to grab PUT options for Q1 on such a move, or pull the trigger and sell. Either way, we see increased volatility on the horizon.

**Note:** Our offices will be closed Thursday and Friday in observance of Thanksgiving. As you reflect on the bounty you have been blessed with, please remember the 1.9 million newly homeless in the Philippines who have lost everything as a result of the devastating typhoon that struck earlier this month. Even better, consider contributing in some way to the relief effort! We appreciate you as our customers, but even more as our friends. May you enjoy this Thanksgiving with family and friends.

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